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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961.

HOUSEHOLD FINANCE CORPORATION,
Appellant,

vs.

DIRECTOR OF THE DIVISION OF TAXATION, DEPARTMENT OF THE TREASURY OF THE STATE OF NEW JERSEY,
Respondent.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY.

JURISDICTIONAL STATEMENT.

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July 9, 1962.

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Respondent.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY.

JURISDICTIONAL STATEMENT.

Appellant appeals from the judgment of the Supreme Court of New Jersey entered January 22, 1962 (rehearing denied March 26, 1962) affirming the judgment of the Division of Tax Appeals, Department of the Treasury of the State of New Jersey, entered March 6, 1961. The Supreme Court of New Jersey is the highest state court available to appellant. New Jersey Constitution, Article VI, Section II, Paragraph 2.

Opinions Below.

The opinion of the Supreme Court of New Jersey, dated January 22, 1962, is reported at 36 N. J. 353, 177 A. 2d 738. A copy of the opinion, order on petition for rehearing and mandate are attached hereto as Appendix A, pp. 1a-15a. The opinion and judgment of the Division of Tax Appeals (unreported) are attached as Appendix B, pp. 16a-35a.

Jurisdiction.

Appellant, a Delaware corporation, and its subsidiaries in the aggregate conduct a financial business in most of the United States and Canada.

This is an appeal from a judgment affirming a franchise tax imposed under a New Jersey statute which denied due process and the equal protection of the law in that as imposed it resulted in the taxation of corporate extraterritorial value. Under the statute the net worth of appellant, a multistate corporation, was allocated for franchise tax purposes under a gross receipts fraction, in which the gross receipts in the numerator and the gross receipts in the denominator, respectively, had no comparable relation to net worth.

This action was brought under the provisions of the New Jersey Financial Business Tax Act (N. J. S. A. 54:10B-1 *et seq.*) to obtain a reversal of the redetermination of the Director of the Division of Taxation, Department of the Treasury of the State of New Jersey of appellant's tax liability for the four tax years 1954 through 1957. The judgment of the Supreme Court of New Jersey is dated January 22, 1962, was entered on said date, rehearing was denied on March 26, 1962, and notice of appeal to this Court was filed in the New Jersey Supreme Court on May 11, 1962.

Jurisdiction of this appeal is conferred on this Court by 28 U. S. C. §1257(a), 62 Stat. 929, and such jurisdiction is confirmed by *Railway Express Agency* v. *Virginia*, 358 U. S. 434, 79 S. Ct. 411, 3 L. Ed. 2d 450 (1959); *Butler Bros.* v. *McColgan*, 315 U. S. 501, 62 S. Ct. 701, 86 L. Ed. 991 (1942); *Connecticut General Life Ins. Co.* v. *Johnson*, 303 U. S. 77, 58 S. Ct. 436, 82 L. Ed. 673 (1938); and *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U. S. 123, 51 S. Ct. 385, 75 L. Ed. 879 (1931). Jurisdiction by writ of certiorari exists

under 28 U. S. C. §1257(3), 62 Stat. 929; 28 U. S. C. §2103, 62 Stat. 962 and the authority of *Charleston Federal Savings and Loan Association* v. *Alderson*, 324 U. S. 182, 65 S. Ct. 624, 89 L. Ed. 857 (1945), rehearing denied 324 U. S. 888, 65 S. Ct. 863, 89 L. Ed. 1436 (1945).

Statutes and Constitutional Provisions Involved.

The pertinent provisions of New Jersey Financial Business Tax Act (N. J. S. A. 54:10B-1 *et seq.*), the validity of which is involved, are attached as Appendix C pp. 36a-41a.

In summary, the act imposes an annual franchise tax measured by the taxpayer's "net worth". N. J. S. A. 54:10B-3. Net worth is defined as the aggregate of capital stock, capital and earned surpluses, surplus reserves and indebtedness owing by the taxpayer to substantial stockholders, N. J. S. A. 54:10B-2(c)(1). Where the taxpayer does business in more than one state, the act provides for apportionment of total net worth so as to determine "the value of its net worth * * * within this State", this apportioned net worth becoming the taxable net worth. The apportioned net worth is the same proportion of total net worth as the proportion of local gross receipts to total gross receipts. N. J. S. A. 54:10B-8. Gross receipts are defined as the aggregate of compensation for financial services, gross profits from trading in securities, interest and dividends received on securities, interest charged to customers on margin accounts and other gross income resulting from the operation of a financial business. N. J. S. A. 54:10B-8. The amount of the tax is determined by multiplying the net worth apportioned to New Jersey by the tax rate of 0.75%. N. J. S. A. 54:10B-3.

The provisions of the United States Constitution involved herein are the due process and equal protection

clauses of the Fourteenth Amendment, Section 1 (hereinafter referred to as "the 14th Amendment").

Questions Presented.

1. In allocating appellant's net worth for state franchise tax purposes by a gross receipts fraction where the fraction's numerator reflecting *local* business is appellant's gross receipts from its customers within the taxing state, and where its *total* business (including that located out of the taxing state) is reflected by a denominator composed of gross receipts of an entirely different type in large part having a substantially lower relation to net worth, does such lack of comparability as between the numerator and the denominator violate the 14th Amendment because it results in taxing extraterritorial values?

2. In allocating appellant's net worth, including a substantial amount of out-of-state assets which are necessary to its business but which directly produce no gross receipts, does the use of a gross receipts allocation fraction violate the 14th Amendment because it results in taxing extraterritorial values?

Statement of the Case.

The issue is whether a method for apportioning appellant's net worth within and without New Jersey violates the Fourteenth Amendment. Appellant is an international as well as an interstate corporate organization with all of its headquarters outside New Jersey. Its net worth is allocated under the New Jersey Financial Business Tax Act for the purpose of assessing a franchise tax on the basis of a gross receipts fraction. As applied to

appellant's facts the gross receipts in the numerator and in the denominator of the allocating fraction had no comparable relation to net worth. This resulted in the allocation of extraterritorial values to New Jersey for franchise tax purposes in violation of the Fourteenth Amendment.

The New Jersey Financial Business Tax Act imposes an annual franchise tax on the taxpayer's net worth. Net worth is defined as the aggregate of capital stock, capital and earned surpluses, surplus reserves and indebtedness of a taxpayer to substantial stockholders. Where the taxpayer does business in more than one state, the act provides that its net worth shall be allocated within and without the state, according to the proportion of its local gross receipts within the state to its total gross receipts during the tax year.

All of appellant's equity investment in and advances to its Canadian subsidiaries and in and to its United States subsidiaries were included in computing appellant's net worth.* But instead of adding the gross receipts from these subsidiaries' customers to appellant's gross receipts in the allocation denominator supposedly reflecting appellant's entire business, the respondent Director added:

> with respect to its Canadian subsidiaries—a substantially smaller figure made up of interest, dividends, and the supervision fees paid by these Canadian subsidiaries to appellant, and
>
> with respect to its United States subsidiaries—a substantially smaller figure made up of interest and the supervision fees paid by them to appellant. No dividends were received by appellant on its stock in its United States subsidiaries, with a minor exception of a small liquidating dividend received in 1950.

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*None of appellant's liabilities, against which its assets were netted, were earmarked or specially allocable to any particular asset or class of assets.

Appellant's net worth also included net values for approximately $21,000,000 to $24,000,000 of other assets necessary to the operation of its business from which appellant directly derived virtually no gross receipts.

All of appellant's investment in and advances to its subsidiaries and in the approximately $21,000,000 to $24,000,000 of other assets had a tax situs outside New Jersey.

By this method, the gross receipts total in the denominator of the allocating fraction is lower in relation to net worth than is the gross receipts total in the numerator. As a result the two factors had no comparable significance as a means of valuing net worth. As applied to appellant's facts this statutory formula allocated extraterritorial value to New Jersey.

It was appellant's contention below and here that if in the application of the statute the taxpayer's total receipts are understated, or the taxpayer's New Jersey receipts are relatively overstated, extraterritorial values are taxed in New Jersey in violation of the 14th Amendment.

As developed from the evidence, the violation of the 14th Amendment is demonstrated by the following comparative figures:

	1954	1955	1956	1957	Total
Total consolidated net worth	$124,731,816.00	$133,803,622.00	$147,068,244.00	$164,312,548.00	—
New Jersey gross receipts	3,340,969.00	3,422,355.00	3,290,420.00	3,398,595.00	—
Total gross receipts per Director	59,461,784.00	72,490,620.00	75,071,317.00	93,971,384.00	—
Actual consolidated gross receipts	82,662,817.00	89,492,255.00	97,185,019.00	114,965,950.00	—
New Jersey taxable % per Director	5.6187	4.7211	4.3831	3.6166	—
New Jersey taxable % based on actual consolidated gross receipts*	4.05	3.82	3.37	2.95	—
Taxable net worth per Director	7,008,307.00	6,317,003.00	6,446,148.00	5,942,526.00	—
Taxable net worth using consolidated gross receipts for apportionment ratio	5,051,639.00	5,111,298.00	4,956,200.00	4,847,220.00	—
Tax per Director	52,562.30	47,377.52	48,346.11	44,568.96	$192,854.89
Tax using consolidated gross receipts for apportionment ratio	37,887.29	38,334.74	37,171.50	36,354.15	149,747.68
Excess tax on extraterritorial value**	14,675.01	9,042.78	11,174.61	8,214.81	43,107.21

* Appellant does not advocate a consolidated gross receipts allocation formula or an allocation formula based on any other specific theory. That is the State's responsibility. The above figures merely demonstrate that when a State requires the use of gross receipts from customers as the numerator of an allocation fraction, the use of a different type of gross receipts in the denominator which are not comparable and bear a lower ratio to net worth arbitrarily allocates extraterritorial values to the taxing State.

** These data disregard a relatively very minor addition made by the respondent Director to appellant's taxable net worth and tax by virtue of certain uncontested adjustments made by him in total gross assets. For example in 1955 only about $140,000 was added to the tax base by uncontested adjustments, resulting in an uncontested tax increase of only about $1,050. Also disregarded as irrelevant and *de minimis* is a liquidating dividend received by appellant in 1956 from one of its United States subsidiaries.

The foregoing comparative figures demonstrate that the New Jersey tax penalizes the use of corporate subsidiaries and disregards headquarters values located outside New Jersey. The New Jersey Supreme Court confirmed this in stating:

> "There is nothing inherently wrong with the statutory plan. The alleged hardship ensued solely from Household's decision to operate in part through subsidiaries." Appendix A, p. 9a.

The Court also stated:

> "• • • [T]he location of headquarters was of no moment. • • • [T]he tangible property stationary at Chicago was devoted to New Jersey activities with the same immediate effect as if the equipment were within our borders." Appendix A, p. 6a.

The unconstitutional application of the New Jersey formula under the 14th Amendment was first raised in the proceedings instituted by appellant in the Division of Tax Appeals, Department of the Treasury of the State of New Jersey, the primary forum for tax appeals of this type in that state (see Appendix E, pp. 45a-47a); and was passed upon by the Supreme Court of New Jersey after that Court certified the proceedings directly to it on appeal from the Division's judgment to the Appellate Division of the Superior Court of New Jersey, (see Appendix A, pp. 5a, 7a, 8a, 10a-11a, 13a; Appendix D, pp. 42a-44a). The Supreme Court of New Jersey, after specifically dealing with the constitutional issues discussed herein, decided them adversely to appellant. See Appendix A, id.

THE QUESTIONS PRESENTED ARE SUBSTANTIAL AND OF GREAT PUBLIC IMPORTANCE.

INTRODUCTION.

Appellant respectfully argues that clear and cogent evidence was presented in these proceedings of the extraterritorial impact upon appellant of the New Jersey franchise tax for each of the four years in issue. By uncontradicted and comprehensive accounting and financial data and expert opinion evidence, appellant proved not only the extraterritoriality of the values so taxed, but the value thereof and the reasons why the tax had such effect.

By the application of the tax New Jersey has deprived appellant of its property without due process of law and has deprived it of the equal protection of the laws. In so doing, the State has disobeyed the constitutional principles of state franchise taxation of a multi-state foreign corporation enunciated in *Wallace* v. *Hines*, 253 U. S. 66, 64 L. ed. 782, 40 S. Ct. 435 (1920); *Hans Rees' Sons* v. *North Carolina, supra; Butler Bros.* v. *McColgan, supra;* and other decisions of this Court. Appellant contends that the statutory fraction was unsuitable in fact and in economic theory for the allocation of a total net worth which included substantial values reflecting headquarters assets and functions and subsidiary investment. Appellant showed: (1) that the statutory fraction inherently and necessarily mismeasures the portion of any taxpayer's net worth reflecting non-revenue-producing headquarters; and (2) that the fraction, being applied upon the basis of intercompany receipts by appellant from its subs instead of the gross receipts of the subs themselves, in fact mismeasures the portion of net worth reflecting the full net value of appellant's investment in wholly-owned subs which themselves received gross receipts. At each point

of mismeasurement the fraction introduced into the New Jersey tax base values which were concededly extraterritorial, and which should therefore be immune to taxation under the 14th Amendment.

I.

The evidence proved taxation of extraterritorial values.

In lieu of reviewing in detail appellant's evidence in this jurisdictional statement, its ultimate thrust can be summarized by three simple examples illustrating how the New Jersey tax statute as applied penalizes the use outside New Jersey of subsidiaries and non-revenue-producing headquarters values.

If appellant had had only one branch office which was in New Jersey and only one subsidiary which was in Canada, each representing a one million dollar investment; and if the branch office and the subsidiary each did a gross business of $100,000 and the subsidiary expended or retained all of its gross receipts, making no payment to appellant, the entire two million dollar net worth of appellant would be allocated to and taxable by New Jersey.

The same result would be reached if appellant owned ten million dollars in cash or other non-revenue-producing net assets with a tax situs outside New Jersey, and had a one million dollar investment in a single branch office operating in New Jersey. Under the theory of the New Jersey Supreme Court, the entire eleven million dollar net worth of appellant would be subject to taxation by New Jersey.

As to the use of corporate subsidiaries, the New Jersey Supreme Court says below:

> "We are not told why Household employed subsidiaries. *A probable motivation was tax advantage somewhere.* The question is whether a state must

adjust its tax laws to avoid a disadvantage a taxpayer may experience because of its decision to incorporate a part of its operation." (Emphasis added) Appendix A, p. 10a.

The purpose served by the use of the subsidiaries is not relevant to the issue of whether the New Jersey allocation fraction allocates extraterritorial values to New Jersey in violation of due process and equal protection. However, in view of the Court's statement, it is pertinent to point out that in appellant's multistate operation, it is necessary to take into account the laws of *all* of the states, the Dominion of Canada, and its provinces where those subsidiaries operate. For example, it is not unreasonable that all Canadian operations should be by Canadian subsidiaries exclusively subject to the laws of that country.

The mere fact that taxpayer has decided

"to incorporate a part of its operation"

does not remove it from the protection of the due process and equal protection clauses, as the New Jersey Supreme Court seems to suggest.

The New Jersey Supreme Court also said:

"• • • the Director, in preparing the allocation fraction, did not include the gross receipts of the subsidiaries, but rather only such sums as Household received from them • • •.

• • • • • •

The sums so paid to Household were less than the gross receipts of the subsidiaries." Appendix A, pp. 9a, 4a.

This use of income from appellant's subsidiaries which the Court stated was

"less than the gross receipts of the subsidiaries"

does not value the portion of net worth attributable to its investment in the subsidiaries by a method comparable to that used to value the portion of net worth attributable to its directly owned New Jersey branch offices.*

The headquarters offices of appellant are located in states outside the State of New Jersey and are, therefore, subject to franchise and property taxation by each of the states wherein they are located. Nevertheless, the Court below stated:

> "Hence in assaying the value of the business privilege in this State, the important thing is the business done here. In this frame of reference, the

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* Appellant's expert witness testified that the use of income from subsidiaries

> "is not a valid method of apportionment. It creates a great distortion, because, while it is based on gross receipts, the gross receipts of the different components of the business are *not the same types of gross receipts*, * * * And, to elaborate on those gross receipts, the gross receipts of the component of the business, that is branches outside of New Jersey and also that of the branches in New Jersey, is the money that the branches have taken in from customers to whom they have lent money.
>
> "The gross receipts of Household Finance Corporation, the taxpayer, from the component of its business, that is investment in subsidiaries, is simply whatever dividends they may happen to pay to the parent company and whatever interest they pay on money borrowed from the parent company.
>
> "Looking beyond the parent company to the gross receipts of the subsidiaries' portion of the business that would be comparable to the gross receipts of the branch business in New Jersey and outside of New Jersey, it would be the actual gross receipts that those subsidiaries received from their customers, rather than simply the interest and dividends from the subs.
>
> "There are two defects in interest and dividends, one being they are in effect something less than the net profit of the subs, the other being that they can vary from year to year, according to how the subs happen to pay them to the parent, without regard to the actual net worth in that investment in subs during that year."

Upon cross-examination, the State's own witness conceded that the Director's method was applied in literal compliance with the statute and without reference to equity, justice or business reality, and he also conceded that various other methods of allocation suggested by Taxpayer were theoretically sound.

> location of headquarters was of no moment. * * * the tangible property stationary at Chicago was devoted to New Jersey activities with the same immediate effect as if the equipment were within our borders. * * * the headquarters assets were wholly unproductive within the walls of the home office; * * *." Appendix A, p. 6a.

Thus, the valuation of the portion of net worth attributable to appellant's headquarters outside New Jersey based upon assets ranging from $21,000,000 to $24,000,000 but which were

> "* * * wholly unproductive within the walls of the home office"

by the gross receipts method is not comparable to valuing the portion of net worth attributable to taxpayer's New Jersey branch office assets yielding approximately 24% in gross receipts before costs. Similarly, if appellant moved its $24,000,000 of headquarters gross assets into New Jersey for the purposes of holding, protecting and using them there, by its headquarters staff of 431 persons, this obvious expansion of its local franchise would be virtually tax-exempt.*

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* This is an example of the temptation of a state to use its tax laws not for revenue but for promotion of local industry. The New York State Tax Structure Committee Interim Report of June 22, 1960, pp. 79-81, describes the results of sales-to-destination allocation as follows:

> "In general the tax will be reduced on firms selling elsewhere goods manufactured in New York state, and will be increased on firms selling in New York goods manufactured in other states. . . . The annual revenue loss of this revision in the sales factor may be expected to be about eight million dollars."

Foreign firms, however, have few if any "political restraints" which they can exert upon the taxing state. *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U. S. 33, 44, 84 L. ed. 565, 570, 60 S. Ct. 388 (1940).

II.

The Fourteenth Amendment forbids the taxation of extraterritorial values.

Fortunately this case does not involve the Commerce Clause. The issues arise solely under the 14th Amendment. Under that Amendment the basic applicable law is simple, well-settled, and unchallenged. The controlling cases are *Hans Rees' Sons, Inc.* v. *North Carolina, supra,* and *Wallace* v. *Hines, supra.*

The famous case of *Butler Bros.* v. *McColgan, supra,* expressly recognized that the validity of an apportionment formula may be challenged by

> "clear and cogent evidence that it results in extraterritorial values being taxed."

This language from *Butler Bros.* was quoted by the Court with approval as late as 1959 in *Railway Express Agency* v. *Virginia, supra.*

The principle was stated in *Alpha Portland Cement Co.* v. *Massachusetts* (1925) 268 U. S. 203, 69 L. ed. 916, 45 S. Ct. 477, in terms of "property" instead of "values" as follows:

> "It must be regarded now as settled that a state may not . . . tax property beyond her borders . . . [T]he 14th Amendment does not permit taxation of property beyond the state's jurisdiction . . .
>
> • • • • • •
>
> "The local business of a foreign corporation may support an excise measured in any reasonable way if neither interstate commerce nor property beyond the state is taxed."

The same principle was expressed in terms of corporate franchises in *Great Atlantic & Pacific Tea Company* v. *Grosjean,* (1937) 301 U. S. 412, 81 L. ed. 1193, 57 S. Ct. 772, as follows:

> "The state may not tax real property or tangible personal property lying outside her borders; nor may she lay an excise or privilege tax upon the exercise or enjoyment of a right or privilege in another state derived from the laws of that state and therein exercised and enjoyed."

The same principle was expressed in terms of "profits" in the famous case of *Hans Rees' Sons* v. *North Carolina* (1931) *supra* as follows:

> "When, as in this case, there are different taxing jurisdictions, each competent to lay a tax with respect to what lies within, and is done within, its own border, and the question is necessarily one of apportionment, evidence may always be received which tends to show that a state has applied a method which, albeit fair on its face, operates so as to reach profits which are in no sense attributable to transactions within its jurisdiction."

The same principle indeed is inherent in every decision in which the validity of an apportionment formula under the 14th Amendment has been considered by the Court, for, as the Court said in *Wallace* v. *Hines, supra:*

> "The only reason for allowing a state to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it, when they are part of an organic system of wide extent, that gives them a value above what they otherwise would possess. The purpose is not to expose the heel of the system to a mortal

> dart—not, in other words, to open to taxation what is not within the state."

It was thus stated in *Norfolk & Western* v. *North Carolina* (1936) 297 U. S. 682, 80 L. ed. 977, 56 S. Ct. 625:

> "This is not to say that a tax is valid as imposed. A formula not arbitrary on its face or in its general operation may be unworkable or unfair when applied to a particular railway under particular conditions . . . If this is made to appear with an ensuing burden on the taxpayer grossly in excess of the results of a more accurate apportionment, the statute to that extent is an unconstitutional endeavor to tax the income of a business in another jurisdiction."

And finally the statute as indicated in *Norfolk & Western, supra,* must be

> "the outcome of a reasonable endeavor to arrive at a proportion of general validity."

It must not seek to accomplish any other purpose than "to get the true value of the things within" the state. It must not be designed to "open to taxation what is not within the state" or to discriminate against one class of taxpayers in favor of another.

This case is distinguishable from *Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331, 84 L. ed. 304, 60 S. Ct. 273 (1939), rehearing denied 308 U. S. 640, 84 L. ed. 531, 60 S. Ct. 273 (1940), where no contention was made that the allocation factor did not adequately reflect the contribution to total capital stock value of the taxpayer's property and business in its Detroit headquarters, including, no doubt, its considerable investment in subsidiaries. In that case the taxpayer argued that the apportionment formula apportioned to the taxing state a capital stock value far in excess

of the real market value of the tangible property in Texas considered in isolation. This issue is not comparable to the issue presented here.

This case is comparable in all essential respects to *Wallace* v. *Hines, supra.* The apportionment of total value of outstanding stocks and bonds in that case on a mileage factor corresponds to the apportionment of total net worth value in this case on a gross receipts factor. The contribution to total outstanding stock and bond value of the extensive out-of-state terminals of the railroad in that case which the mileage factor failed to measure corresponds to the contribution to total net worth of the out-of-state property and business of appellant's headquarters and commercial domicile which the gross receipts factor in this case fails adequately to measure. And the contribution to total capital stock and bond value of the out-of-state investment portfolio in that case which the mileage factor failed to measure corresponds to appellant's out-of-state investment in its subsidiaries which this gross receipts factor fails adequately to measure. The apportionment reviewed in *Wallace* v. *Hines, supra,* was held to be invalid.

This case is also comparable to *Hans Rees' Sons* v. *North Carolina, supra.* There a single apportionment factor of *property* did not adequately measure the contribution to entire net income of economic activity outside the state. Here the single gross receipts factor does not adequately reflect in fact the contribution to entire net worth of the out-of-state investment in subsidiaries and other headquarters assets. See Altman and Keesling, *Allocation of Income in State Taxation* (C. C. H., 1950, 2nd ed.) 97, 108, 118.

As in *Wallace* v. *Hines* and *Hans Rees' Sons* v. *North Carolina,*—and in contrast to *Ford Motor Co.* v. *Beauchamp,*

—it is respectfully submitted that the uncontradicted evidence offered in the Division of Tax Appeals by Taxpayer is clear and cogent that New Jersey has measured its tax against Taxpayer by extraterritorial values. Its tax base is demonstrably too big in comparison with all other measurement techniques adduced; its apportionment method is incapable of application as a principle to various wholly genuine parts of Taxpayer's net worth; there is nothing conjectural about the accountancy reasons for this result. In short, New Jersey has taxed the exercise of franchises with which it has nothing to do, and would more or less completely exempt from taxation the same franchises if exercised within New Jersey by a comparable corporation with a local commercial domicile. The record demonstrated, not only the fact of extraterritorial tax impact, but the actual dollar extent of it and the reasons why it occurred.

Appellant's factual situation is not unique. Many multistate corporations have wholly owned subsidiaries and make advances to them. Foreign countries and various of the United States may require that business done within their jurisdictions shall be by corporations locally incorporated. Foreign countries and individual states may grant special powers to corporations locally incorporated which create opportunities not available to foreign corporations. Most corporations own bank balances, bonds, and similar assets on which the gross rate of return is nil or materially lower than the gross return such corporations receive from their dealings with customers. These intangibles normally have a tax situs at the corporation's home office, where the corporation is also subject to tax.

Every multistate corporation also has a home office located in a specific state. The corporate franchise to maintain that office involves the use within the state of sub-

stantial amounts of capital and labor which subjects the corporation to taxes in that state on a proportionate part of its total net worth. See *Adams Express Co.* v. *Ohio State Auditor*, 166 U. S. 185, 224-225, 41 L. ed. 965, 979, 17 S. Ct. 604 (1897).

It will gravely restrict the opportunities available to multistate corporate managements if their use of subsidiaries subjects them to state taxation on their extraterritorial values.

The Commerce Clause of the Constitution has been exhaustively construed by this Court in the field of state taxation. So long as it was originally a prohibition against any state taxation burdening interstate commerce, it was the primary consideration in tax cases. Lately the prohibitory effect of the Commerce Clause has been relaxed, so that earlier decisions of this Court construing the Fourteenth Amendment as a restriction on the right of any state to tax values outside that state's territory have received a new importance. Congress is presently analyzing multistate taxation for the purpose of enacting legislation to promote uniformity of such taxation within stated restrictions, and undoubtedly would benefit from a restatement, by this Court in this appeal, of 14th Amendment principles in the light of modern interstate and international business organization.

The questions under the 14th Amendment raised by this record, therefore, are important to most multistate corporate taxpayers, to all state legislatures and tax administrators in states using a gross receipts allocation method, and to Congress. The impact of the 14th Amendment on the power of a state to tax extraterritorial values presents questions of such substantial merit, as to require plenary consideration with briefs on the merits and oral argument for their resolution.

Conclusion.

This Court can advance the science of multistate taxation immeasurably by accepting this appeal as presenting a substantial federal question. There have been very few cases heard recently and in detail by this Court arising under the 14th Amendment and requiring the review of evidence claimed to show the taxation of "extraterritorial value", especially when unencumbered by the Commerce Clause.

The issue is whether a method for apportioning total net worth value within or without the taxing state is valid under the 14th Amendment when it uses a gross receipts formula in which the gross receipts in the numerator and the gross receipts in the denominator, respectively, has no comparable relation to net worth.

Respectfully submitted,

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Dated: July 9, 1962.

Appendix A.

Opinion, Order on Petition for Rehearing and Mandate of Supreme Court of New Jersey.

SUPREME COURT OF NEW JERSEY,

A-47—SEPTEMBER TERM—1961.

HOUSEHOLD FINANCE CORPORATION,
a Delaware Corporation,
Appellant,

v.

DIRECTOR OF THE DIVISION OF
TAXATION,
Respondent.

Argued November 20 and 21, 1961. Decided January 22, 1962.

The opinion of the court was delivered by WEINTRAUB, C. J.

This case involves assessments against Household Finance Corporation (herein "Household") under the New Jersey Financial Business Tax Law (1946), N. J. S. A. 54:10B-1, *et seq.*, for the years 1954 to 1957, inclusive. The Division of Tax Appeals sustained the assessments and we certified Household's appeals before the Appellate Division acted upon them.

The history of the Financial Business Tax Law (1946) appears in *Morris & Essex Investment Co.* v. *Director of Division of Taxation*, 33 N. J. 24 (1960). As there pointed out, the statute was devised against the backdrop of the federal statute, 42 Stat. 1499, 12 U. S. C. §548(1)(b) (1958), which provides that the tax imposed by States upon the shares of national banks "shall not be at a greater rate than

is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks." The ultimate criterion under the federal act is whether moneyed capital employed in competition with the business of national banks receives favored tax treatment (33 N. J. at 30). Our taxing statute seeks to achieve equality despite differences in the underlying economics of enterprises which thus compete with national banks.

To that end the statute imposes "an annual excise tax" at the rate of ¾ of 1% upon "net worth" less certain deductions, which tax is "in lieu of any State franchise tax or of any State or local taxation of, upon or measured by personal property entering into the determination of net worth." N. J. S. A. 54:10B-3. With respect to a taxpayer doing business in more than one State, the act provides for an allocation to this State of a portion of its total net worth, "according to the proportion of its gross business in this State to its gross business everywhere during the tax year." N. J. S. A. 54:10B-8.

Household is engaged in the small-loan business. It operates extensively in the United States and also in Canada. In the years in question it maintained between 417 and 445 branch offices in the United States, of which 17 were in New Jersey. It also owned subsidiary corporations which in the United States totaled 24 as of the end of 1953 and numbered 155 by the end of 1956. With one exception, not here significant, the subsidiaries were wholly owned by Household. There were no subsidiaries in New Jersey in 1954; there were two in 1955; seven in 1956, and ten in 1957. Of these, one was active in 1956 and four in 1957. The Canadian business was conducted through subsidiaries. The subsidiaries operating in New Jersey are herein called "New Jersey subsidiaries" although they are foreign corporations, a fact which is of no moment.

Appendix A.

The business conducted directly by Household at its many branch offices was the same as that conducted at the local offices owned by the subsidiaries. So also the operating relationship between Household and the local offices was the same whether they were branches or were individually incorporated. The principal headquarters were in Chicago, and regional offices were maintained in New York, Philadelphia, Detroit, and Los Angeles. Policy decisions were made in Chicago. Supervisory and administrative services, including the training and assignment of local supervisory personnel, were handled there. Services were thus centrally furnished in purchasing, leasehold management, research, advertising, and public relations. Each branch office maintained its own books but reported daily to Chicago where duplicate records were maintained. Headquarters supplied the funds needed by local offices, whether branch or incorporated, to meet the business opportunities as they appeared, and the several offices remitted regularly such funds as headquarters decided to recall.

Household concedes its entire operation was unitary in character.

In its returns for the years in question Household sought in effect to separate its direct operations through branch offices from the operations of the subsidiaries. To that end it first excluded from net worth its equity investment in the subsidiaries. It then applied an allocation fraction in which the numerator was the gross receipts of the New Jersey *branch* offices and the denominator was the gross receipts from all *branches*. Thus Household did not include in the denominator the gross receipts of the subsidiaries or Household's receipts from its subsidiaries.

The Director made a redetermination. He included in net worth the equity investment in subsidiaries. He added to the denominator of the allocation fraction the sums

received by Household from the subsidiaries, *i. e.*, interest, dividends and service fees charged for the sundry services Household furnished the subsidiaries. The Director agreed with Household that with respect to the subsidiaries operating in New Jersey (they filed separate returns), the net worth of Household should be reduced by its investment in them in accordance with N. J. S. A. 54:10B-6(a)(3). Household's receipts from the New Jersey subsidiaries were not included in the numerator of the allocation fraction.

The redetermination thus followed the corporate lines established by Household. Household then complained that the Director, by taking in the shares in subsidiaries at their book value, in effect "consolidated" the enterprise in fixing net worth, and hence should use a "consolidated" approach in fixing the denominator of the allocation fraction by including therein the gross receipts *of* the subsidiaries, rather than only so much as reached Household *from* the subsidiaries by way of interest, dividends and service fees. The sums so paid to Household were less than the gross receipts of the subsidiaries. Hence, if a "consolidated" approach were used, the denominator of the allocation fraction would be enlarged, thereby reducing the portion of total net worth allocable to New Jersey. As we will later develop, Household did not, however, seek a fully consolidated result.

Household also advanced the further claim that its so-called "headquarter assets" were situate in Chicago, and should be deducted from net worth. This contention in fact departed from Household's returns, since therein it had not sought to deduct headquarter assets from net worth.

The Division of Tax Appeals sustained the redetermination. The issues before us are the ones described in the

two preceding paragraphs. We will treat first with the claim that headquarter assets should be excluded from net worth and then consider the attack upon the allocation fraction.

I.

In the years in question the headquarter assets ranged from $21,000,000 to $24,000,000. They included accounts receivable, government securities, office equipment, and deferred charges, but the great bulk consisted of cash on hand, in banks and in transit. For example, at the beginning of 1954, cash amounted to $22,511,984 of total headquarter assets of $24,098,252. The cash items constituted the revolving fund from which Household dispatched moneys to the various local offices to meet the business opportunities there.

As indicated above, Household argues that these assets have their situs in Chicago and that unless they are excluded from net worth, New Jersey would tax extraterritorial values in violation of the due process provision of the Federal Constitution.

The statute does not tax assets beyond the State. Rather, it imposes an excise tax upon the doing of financial business in New Jersey. N. J. S. A. 54:10B-3. That the tax is assessed upon a portion of net worth does not mean that it is an *ad valorem* assessment upon any of the underlying properties. *Werner Machine Co.* v. *Director of Division of Taxation*, 17 N. J. 121 (1954), affirmed, 350 U. S. 492, 100 L. Ed. 634 (1956). Net worth simply sums up the relationship between assets and liabilities and thus expresses the experience of an enterprise. It is not "property" and of course is not an "asset" in a balance sheet. It is merely a concept, without tangible situs in any specific asset.

Appendix A.

In a sense, the excise tax may gather the hue of a property tax, but if so viewed, it is the franchise to do local business that is being valued rather than any specific piece of property devoted to it. In thus appraising the worth of a franchise, it is fitting to refer to "net worth," for the franchise ultimately contributes to that balance-sheet result. And in dealing with a multi-State business, unitary in nature, it is reasonable to assume the franchise to do business in this State contributes to the net worth in the proportion that the business done here bears to the total business of the taxpayer.

Hence in assaying the value of the business privilege in this State, the important thing is the business done here. In this frame of reference, the location of headquarters was of no moment. Headquarter assets were part of an operating whole, and were employed wherever the taxpayer did business. They were directly employed in New Jersey to the extent that cash was sent here as needed, and the tangible property stationary at Chicago was devoted to New Jersey activities with the same immediate effect as if the equipment were within our borders. Indeed, in terms of the small-loan business to which Household's enterprise was devoted and from which its net worth emerged, the headquarter assets were wholly unproductive within the walls of the home office; they generated results only by meaningful employment at the sundry places where the small loans were made.

If we recur to the legislative purpose mentioned above, *i.e.*, to prevent tax preference for competitors of national banks, we find confirmation of the conclusion we have reached. It is the business done in this State which competes with the national banks. The tax imposed upon competitors should take into account the amount and value of that business. The headquarter assets contributed to

the competition in this State as effectively as if that reservoir were here. They accordingly should not be excluded in calculating the net worth of the unitary operation.

In *Household Finance Corp.* v. *State Tax Comm'n*, 212 Md. 80, 128 A. 2d 640 (Ct. App. 1957), this taxpayer advanced without success the same contention we have rejected. There the taxpayer urged the inclusion of headquarter assets in ascertaining the value of its capital stock violated the Federal Constitution. The Maryland court found no substance in the claim.

We think the issue is controlled by *Ford Motor Co.* v. *Beauchamp*, 308 U. S. 331, 336, 84 L. Ed. 304, 306-07 (1939), where the Court said:

> "In a unitary enterprise, property outside the state, when correlated in use with property within the state, necessarily affects the worth of the privilege within the state. Financial power inherent in the possession of assets may be applied, with flexibility, at whatever point within or without the state the managers of the business may determine. For this reason it is held that an entrance fee may be properly measured by capital wherever located. The weight, in determining the value of the intrastate privilege, given the property beyond the state boundaries is but a recognition of the very real effect its existence has upon the value of the privilege granted within the taxing state."

II.

The remaining question concerns the allocation formula —the statutory fraction in which the numerator is the gross receipts in New Jersey and the denominator is the total gross receipts of the business.

Appendix A.

It is settled that an apportionment formula will be sustained unless it is "palpably unreasonable," and the burden is the taxpayer's to prove by "clear and cogent evidence" that it results in the taxation of extraterritorial values. *Railway Express Agency* v. *Virginia*, 358 U. S. 434, 443, 444, 3 L. Ed. 2d 450, 457 (1959).

To sustain its charge, Household offered testimony of other possible bases of apportionment, such as payroll, assets, etc. Its witness conceded all of his suggestions contained some defects. The question is not whether some other technique could be used, but whether the formula the Legislature selected is palpably unfair. An allocation formula based upon gross receipts seems to us to be thoroughly sound when applied to a business such as Household's. Surely the formula does not bespeak an invidious purpose to tax what is not here. And a result of that character is not shown by proof that some basis other than gross receipts would yield a smaller tax. We find no demonstration that a gross-receipts fraction allocated to New Jersey a portion of net worth beyond that in fact attributable to New Jersey business.

The troublesome aspect of this case stems, not from the use of a gross-receipts formula, but rather from the fact that Household operated in part through branch offices and in part through subsidiaries. The Director included in net worth the value of Household's shares in its subsidiaries. This was plainly correct since the shares were an integral part of the total assets which constituted the strength against which Household was able to borrow huge sums at favorable rates, which sums it parceled out among the local offices for small loans by them. Household does not now question the inclusion of the shares or the use of book value in their valuation. Rather it complains of the allocation fraction the Director used. As we have already noted,

the Director, in preparing the allocation fraction, did not include the gross receipts of the subsidiaries, but rather only such sums as Household received from them by way of interest on advances (which was at a lesser rate than the subsidiaries collected on small loans), dividends (as a matter of Household's own policy, the subsidiaries in the United States declared no dividends in the years in question), and service fees which Household received from the subsidiaries.

The Director thus dealt with Household in accordance with its own corporate structure. The redetermination was upon an "unconsolidated" basis. The statute does not authorize a consolidated return. *General Public Loan Corp.* v. *Director of the Division of Taxation*, 13 N. J. 393, 400, 404 (1953). So N. J. S. A. 54:10B-6(a)(3) provides there may be deducted from net worth the value of shares "in corporations taxable under this act" upon the formula there set forth. N. J. S. A. 54:10B-7 and 8 continue the non-consolidated theme. Indeed by chapter 308 of L. 1950 the section last cited was amended to provide with respect to multi-State operations that a wholly owned subsidiary having capital stock with a par or stated value of $5,000 or less be deemed, in effect, a part of the taxpayer's direct business operation. The statement annexed to the bill which became that amendatory act reveals the evident purpose of giving "the benefit of the allocation provision" to taxpayers doing business in other States through such subsidiaries, "a situation comparable to that of a taxpayer doing business directly in other States." Thus the Legislature expressly determined to permit consolidation only with respect to subsidiaries of such limited capitalization.

There is nothing inherently wrong with the statutory plan. The alleged hardship ensued solely from Household's decision to operate in part through subsidiaries. Although

the cases recognize that a formula fair on its face may offend constitutional limitations when in its actual operation it plainly taxes extraterritorial property or activity, *Hans Rees' Sons, Inc.* v. *North Carolina ex rel. Maxwell*, 283 U. S. 123, 75 L. Ed. 879 (1931); *Wallace* v. *Hines*, 253 U. S. 66, 64 L. Ed. 782 (1920), we know of no case in which constitutional infirmity was grounded upon a refusal to disregard corporate lines.

The issue was advanced in *Household Finance Corp.* v. *State Tax Comm'n, supra* (212 Md. 80, 128 A. 2d 640), where a consolidation was found, by a vote of 3 to 2, to be authorized by the statute itself, the majority not reaching the question whether the result was constitutionally required. A similar contention was rejected in *Commonwealth* v. *Ford Motor Co.*, 350 Pa. 236, 245-46, 38 A. 2d 329, 334 (Sup. Ct. 1944).

We are not told why Household employed subsidiaries. A probable motivation was tax advantage somewhere. The question is whether a State must adjust its tax laws to avoid a disadvantage a taxpayer may experience because of its decision to incorporate a part of its operation. As a general proposition, the answer must be that it is for the taxpayer to make its business decisions in the light of tax statutes, rather than the other way around. See *Higgins* v. *Smith*, 308 U. S. 473, 477, 84 L. Ed. 406, 411 (1940); *Vim Securities Corp.* v. *Commissioner*, 130 F. 2d 106, 109 (2 Cir. 1942); *Bonnar-Vawter, Inc.* v. *Johnson*, ... Me. ....., 173 A. 2d 141 (Sup. Jud. Ct. 1961); *Washington Sav-Mor Oil Co.* v. *Tax Comm'n*, ... Wash. 2d ....., 364 P. 2d 440 (Sup. Ct. 1961); Annotation, 64 A. L. R. 2d 769 (1959).

The authorities just cited may not be precisely in point, since they did not involve the problem of apportionment of a tax base of a multi-State business. Nonetheless, corporate lines are real. Moreover, taxation is an intensely practical

thing, and the administrative burden may well be too much if a State must explore the ramifications of corporate structures to determine the justice of recognizing or ignoring corporate entities in each factual complex.

At any rate we need not decide whether a consolidated approach would have to be allowed in a case in which it cogently appeared an unconsolidated basis allocated a portion of net worth palpably beyond what is reasonably attributable to the New Jersey activity. First, the facts do not demonstrate a palpable misapportionment. *Cf. Norfolk & W. Ry.* v. *North Carolina ex rel. Maxwell*, 297 U. S. 682, 80 L. Ed. 977 (1936). Second, Household did not seek consolidated treatment.

What Household sought was a hybrid result under which its corporate lines would be respected as to New Jersey operations and disregarded elsewhere. More specifically, Household wanted the right to file separate returns for the New Jersey subsidiaries while using a consolidated approach with respect to the others. It in fact did file separately for the New Jersey subsidiaries, and upon the redetermination insisted before the Director that their net worth be excluded from total net worth under N. J. S. A. 54:10B-6(a)(3), a proposition with which the Director agreed. So also Household excluded the gross receipts of New Jersey subsidiaries from the allocation fraction.

After oral argument we sought clarification of Household's position in this respect. We were informed:

> "However, the statute (§6) requires that Taxpayer's subsidiaries which are active in New Jersey be separately taxed on their own local franchises. The statute shows a clear legislative intent to draw a distinction between the local subs' own franchise to operate locally, which is separately taxable, and

> the Taxpayer's distinctive franchise to own those subs, which is taxable or not according to where it is held and exercised. Accepting the statutory distinction (as both parties do), the problem is simply to measure the portion of Taxpayer's net worth which represents this value and to determine its taxable situs."

and further:

> "* * * Moreover, if the disregard of corporate lines appears to be only a partial one (that is, the middle ground under which Taxpayer's New Jersey subs are fractioned off individually), this is solely because of the explicit requirements of §6, which requirements, incidentally, both parties accept and which therefore should be accepted by the Court as binding for the purposes of this appeal."

Quite obviously, if the gross receipts of the New Jersey subsidiaries were included in the numerator and denominator of the allocation fraction, the fraction would be enlarged. This is apparent from a simple example, let us say, of adding 5 to the numerator and denominator of the fraction 5/20 which would result in the fraction 10/25. If the fraction, augmented above and below the line by the gross receipts of the New Jersey subsidiaries, were applied to the total net worth, the portion allocable to New Jersey would not necessarily be the same as the total of (1) the net worth of the New Jersey subsidiaries and (2) the portion of Household's remaining net worth allocated to New Jersey by a fraction having the New Jersey branch office receipts as the numerator and "consolidated" gross receipts as the denominator. We do not know the tax-dollar consequences for the

years in question of that dual approach, but it seems clear that, in espousing the split approach we have described (*cf. Household Finance Corp.* v. *State Tax Comm'n*, 217 Md. 327, 142 A. 2d 807 (Ct. App. 1958)), Household seeks an opportunity to control its total tax by the expedient of deciding which New Jersey offices to operate through subsidiaries and which to operate as branches.

The statute permits Household to operate in New Jersey through subsidiaries with separate treatment of them. Household simply seeks to fashion still another choice, whereby it may "consolidate" its out-of-State operations while maintaining the integrity of corporate lines with respect to the New Jersey segment of its total operations. The statute does not permit and surely due process does not require that incongruity.

The judgments are affirmed.

Appendix A.

Order on Petition for Rehearing.

SUPREME COURT OF NEW JERSEY

HOUSEHOLD FINANCE CORP., Appellant, *vs.* DIRECTOR, DIVISION OF TAXATION, Respondent.	Docket No. 3573 On Petition for rehearing.

This matter having been duly presented to the Court, and no justice who voted with the majority having moved a reconsideration, it is Ordered that the petition for rehearing is denied.

Witness, the Honorable Joseph Weintraub, Chief Justice, at Trenton, this 26th day of March 1962.

JOHN H. GILDEA
Clerk

Filed.
Mar. 26, 1962.

JOHN H. GILDEA
Clerk

A True Copy

JOHN H. GILDEA
Clerk.

Appendix A.

Mandate on Affirmance.

SUPREME COURT OF NEW JERSEY.

APPEAL DOCKET NO. 3575.

HOUSEHOLD FINANCE CORPORATION, a Delaware Corporation,
Appellant,
vs.
DIRECTOR OF THE DIVISION OF TAXATION,
Respondent.

Civil Action
On Appeal

This cause having been duly argued before this Court by Mr. Roger C. Ward, counsel for the appellant and Mr. Alan B. Handler, counsel for the respondent, and the Court having considered the same,

It is hereupon ordered and adjudged that the judgments of the said Division of Tax Appeals are affirmed with costs; and it is further ordered that this mandate shall issue ten days hereafter, unless an application for rehearing shall have been granted or is pending, or unless otherwise ordered by this Court, and that the record be remitted to the Division of Tax Appeals to be there proceeded with in accordance with the rules and practice relating to that court, consistent with the opinion of this Court.

WITNESS the Honorable JOSEPH WEINTRAUB, Chief Justice, at Trenton on the 22nd day of January, 1962.

FILED
Jan 22 1962
JOHN H. GILDEA
Clerk

JOHN H. GILDEA,
Clerk of the Supreme Court.

A True Copy

JOHN H. GILDEA
Clerk.

Appendix B.

Opinion and Judgment of Division of Tax Appeals, State of New Jersey.

STATE OF NEW JERSEY

DEPARTMENT OF THE TREASURY

DIVISION OF TAX APPEALS

HOUSEHOLD FINANCE CORPORATION,
A Delaware Corporation,
Petitioner,

vs.

DIRECTOR OF THE DIVISION OF TAXATION,
Respondent.

Opinion

KOPP, C.

This is an appeal by the petitioner, Household Finance Corporation, a Delaware Corporation, authorized to do business in New Jersey, from taxes assessed against it by the respondent, Director of the Division of Taxation, under the Financial Business Tax Act, N. J. S. A. 54:10B-1 *et seq.* for the tax years 1954, 1955, 1956 and 1957. After a pre-trial before the Division of Tax Appeals sitting *en banc*, the matter was assigned to me under N. J. S. A. 54:2-41.1 (a) and Rule 16:8-10.100 (1) for hearing and determination and the hearing was held on January 12, 1960. Thereafter, both parties filed briefs and supplemental briefs.

FACTS.

Petitioner is and was engaged in the business of lending money at branch offices within and without New Jersey.

Appendix B.

During the years in question it owned and operated within this State 17 branch loan offices and outside of New Jersey it owned and operated some 417 to 445 branch offices in 27 or 28 states as licensee under state small loan or similar laws. Petitioner's business in New Jersey is a "financial business" within the meaning of Section 2(b) of the New Jersey Financial Business Tax Law, (1946), N. J. S. A. 54:10B-1 *et seq.*, and was subject to the tax imposed by said statute.

In addition to conducting its financial business through branch offices, petitioner also owned, managed and controlled all, or substantially all, of the capital stock of certain subsidiary corporations, none of which were New Jersey corporations. Such subsidiaries were engaged in the business of lending money in the various states of the United States or in Canada, and some subsidiaries operated in New Jersey. On its books and in its New Jersey Financial Business tax returns, petitioner carried and reported its investment in the stock of its subsidiaries at cost.

Petitioner maintains its headquarters office in Chicago, Illinois, with regional headquarters offices during the years in question in New York, Philadelphia, Detroit and Los Angeles. Headquarters furnishes all branch offices, subsidiaries and subsidiary branch offices with similar accounting, advertising, supervisory and other administrative services. Personnel is sometimes interchanged among the branches, subsidiaries and subsidiary branches. Money to lend is forwarded by headquarters to all branches and subsidiaries and all remit any excess of funds to or as directed by headquarters. Each branch office maintains its own books of account but makes daily reports to headquarters where a duplicate set of accounts is maintained.

Petitioner owns no real property. All offices, both headquarters and branch, are rented. The same applies to the

subsidiaries except that one of the Canadian subsidiaries owns the premises in Toronto in which the Canadian principal administrative office is located. The tangible assets of petitioner consist almost entirely of office equipment and its intangibles consist principally of notes receivable from customers and stock in and advances to subsidiaries.

Receipts of petitioner consist of interest collected from customers through its own branch offices and dividends, interest and supervision fees from subsidiaries. All subsidiaries were regularly charged a supervision fee which was determined as a proportion of the general administrative expenses. As to U. S. subsidiaries the apportioning factor was the average of the ratios of number and amount of loans outstanding to total. The formula as to Canadian subsidiaries was slightly different.

Petitioner duly filed its Financial Business Tax Returns for the tax payment years in question, i. e., 1954, 1955, 1956 and 1957 and in each of said returns, it computed what it termed its "New Jersey Taxable Net Worth" as of December 31 of the year preceding the particular tax-payment year as follows:

(a) Its entire net worth per its books was increased by decreasing its bad debt reserve to conform to what it then believed to be the requirement of the Division of Taxation.

(b) It then excluded from its net worth, as so adjusted, that part of it represented by what it termed its "non-financial or holding company business outside of New Jersey". This was done by excluding from its total net worth, that proportion thereof which the value per books of its stock in, and advances to, its subsidiaries bore to petitioner's total assets per books.

Appendix B.

(c) Of the remaining net worth which petitioner termed its "Financial Business Net Worth", the petitioner then allocated that part of such "Financial Business Net Worth" as was represented by its financial business within New Jersey. This was done by allocating to New Jersey that proportion of its total "Financial Business Net Worth" which the petitioner's gross income from its financial business within New Jersey, bore to its total gross income from its financial business both within and without New Jersey. This residue petitioner termed its "New Jersey Taxable Net Worth". In making this allocation petitioner excluded from "financial business gross income", both within and without New Jersey, all interest, dividends and supervision fees received from its subsidiaries.

Petitioner's method of determining "New Jersey Taxable Net Worth" may be illustrated by reviewing such computation for the year 1954, which is as follows:

1.	Entire net worth per books	$102,229,444.00
2.	Adjustments:	
	(a) Add, adjustment of bad debt reserve	11,220,171.00
		$113,449,615.00
	(b) Deduct, non-financial net worth	31,491,196.00
3.	Balance represents "financial business net worth"	$ 81,958,419.00
4.	Line 3 x 5.88148018%* equals "New Jersey Taxable Net Worth"	$ 4,820,368.00

* 5.88148018% being the ratio equivalent to the fraction:
New Jersey Financial Business Gross Income (over)
Financial Business Gross Income within and without N. J.

Appendix B.

On July 29, 1957 the Corporation Tax Bureau notified petitioner of a redetermination of its tax liability for each of the four years 1954 to 1957 both inclusive. By such redetermination the Bureau recomputed petitioner's "New Jersey Taxable Net Worth" as set forth on the tax returns filed for each of said years, in the following manner:

(a) The Bureau first increased petitioner's total net worth (as adjusted by petitioner in said returns), by adding thereto certain amounts representing dividends payable to petitioner's stockholders holding more than 10% of petitioner's total outstanding stock, as required by N. J. S. A. 54:10B-2(c)(1)(5).

(b) The Bureau then decreased such adjusted net worth by increasing petitioner's bad-debt reserve to an amount equal to the moving average loss experience, plus a 1% safety factor.

(These two adjustments (a) and (b) are not in issue.)

(c) To petitioner's total net worth as so adjusted the Bureau then added an amount equal to the excess of the fair value of the petitioner's investment in stock of subsidiaries over the amount reported as the value on the petitioner's returns.

(d) As a further adjustment the Bureau then restored to total net worth the amount excluded by the petitioner as being that portion of its net worth represented by what it termed its "non-financial or holding company business outside of New Jersey". The resulting amount was considered by the Bureau to represent the petitioner's total adjusted net worth.

(e) The Bureau then allocated to New Jersey that proportion of total adjusted net worth which petitioner's gross income from business within New Jersey bore to the sum of petitioner's gross income from both within and without New Jersey. The gross

income so used included interest, dividends and supervision fees received from subsidiaries. The resulting amount was determined by the Bureau to be the petitioner's taxable net worth on which the tax was computed.

The Bureau's method of determining Taxable Net Worth may be illustrated by reviewing such computation for the year 1954, which is as follows:

1. Net worth reported by petitioner (termed financial business net worth)	$ 81,958,419.00
2. Adjustments	
(a) Add, dividends payable to stockholders	294,000.00*
(b) Deduct, increase in reserve for bad debts	(1,749,893.00)*
	$ 80,502,526.00
(c) Add, increase to bring value of subsidiaries to true value	12,738,094.00
(d) Add, amount excluded by petitioner as representing net worth of non-financial business	31,491,196.00
3. Adjusted net worth	$124,731,816.00
4. New Jersey allocation percentage (ratio of total gross income from within N. J. to total gross income from within and without N. J.)	5.6187%
5. Taxable net worth (line 3 x line 4)	$ 7,008,307.00

* These adjustments are not contested by petitioner.

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The redetermination resulted in an assessment of additional taxes for each of the four years in question which together with the interest charged thereon aggregated $55,498.52 which petitioner paid, under protest, on August 12, 1957. Thereafter, petitioner sought and obtained a formal hearing before the Supervisor of the Bureau, who sustained the Bureau's assessments and this appeal followed.

CONTENTIONS OF PETITIONER.

Briefly stated, petitioner's arguments against respondent's redeterminatiion are as follows:

1. Petitioner asserts that in addition to its general small loan business operated through its branches, it also engaged in a holding company business, consisting of beneficially owning, holding, managing and controlling all, or substantially all, of the capital stock of certain subsidiary corporations. It admits that its entire business may be viewed as a unitary one in that its subsidiaries and their financial business are related to the rest of its financial business both by the normal corporate and financial relationship of subsidiary to parent and in an economic operating sense, but it argues that the subsidiaries and petitioner's business with respect to them are located and operated outside New Jersey and that this integral part of the unitary business must be accurately and fully segregated out of the New Jersey tax base.

And further, in this regard, petitioner urges th[illegible] if it be found (and this it does not concede) that this foreign business did cast any indirect value upon the New Jersey franchise, this should be measured by reasonably accurate apportionment and measurement of the New Jersey franchise itself. This respondent has failed to do and, instead,

has incorporated it into the tax base and, therefore, directly taxed this extraterritorial value.

2. Petitioner argues that its total net worth reflected (among other things) the value according to its books of its investment in certain property, both tangible and intangible, which it termed "Headquarters Property". Such property was located at its home office in Chicago, Illinois, and consisted of general corporate cash on hand and in banks; headquarters office equipment, and certain other miscellaneous items. Since said Headquarters Property, although used in the management of petitioner's entire business, was located entirely outside of New Jersey, that proportion of petitioner's net worth which said Headquarters Property bore to petitioner's total assets, was and is outside the territorial limits of, and not taxable by, New Jersey. Therefore, in determining petitioner's New Jersey Taxable Net Worth the aforesaid proportion of net worth should be excluded from petitioner's adjusted net worth, in order to exclude from taxation by New Jersey the portion thereof represented by such non-income producing Headquarters Property located outside New Jersey.

3. Petitioner argues that respondent erred in increasing its net worth as reported by an amount equal to the amount by which the book value of petitioner's stock in its subsidiaries per the subsidiaries' books exceeded the book value, or cost thereof, per the petitioner's books. Such an adjustment, it urges, is equivalent to valuing petitioner's net worth on a consolidated basis.

4. Petitioner argues that respondent was wrong in his method of computing the New Jersey allocation factor in three respects. (a) Inclusion in gross income of dividends,

interest and supervision fees received from subsidiaries was improper since such receipts were no part of petitioner's gross income from its financial business as defined in N. J. S. A. 54:10B-8.

(b) The inclusion of petitioner's receipts from its subsidiaries on an unconsolidated basis was inconsistent with the adjustment and redetermination of petitioner's total net worth on a consolidated inter-company basis. It contends that if it be lawful and proper to redetermine petitioner's total net worth on a consolidated basis, then the statute requires that the petitioner's New Jersey allocation percentage be likewise computed on a consolidated basis.

(c) Petitioner claims that its net worth is separable into three layers. The first represents that portion of net worth invested in headquarters property. The second represents its investment in subsidiaries. The third represents its investment in the business of conducting small loan activities in the several states. This being so, petitioner urges, no one allocation factor should be used to allocate the entire three layer cake but rather each layer should be allocated separately.

5. Petitioner argues that if N. J. S. A. 54:10B-1 *et seq.* must be literally applied, it is unconstitutional because it violates the Constitution of the United States in that the allocation factor as provided by Section 8 thereof, results in exacting a tax on property outside New Jersey without due process and denies a non resident taxpayer equal protection of the law.

6. Petitioner argues that if N. J. S. A. 54:10B-1 *et seq.* is not unconstitutional, the respondent has applied it in an unconstitutional manner and, therefore, in so doing has

violated both the Statute and the Constitution of the United States.

7. Petitioner argues that N. J. S. A. 54:10B-10 permits the respondent to modify the literal meaning of the act and avoid an unconstitutional application thereof.

8. Finally petitioner argues that the inclusion in its net worth of advances it has made to its subsidiaries, who also do business in New Jersey, results in double taxation with respect to the same portion of net worth inasmuch as N. J. S. A. 54:10B-2(c)(1)(5) requires such subsidiaries to include in their net worths amounts owing to their parent. Petitioner complains that Section 6(a) provides only for adjustment in respect to value of stock of subsidiaries and gives no relief in respect to double taxation resulting from inclusion of advances.

CONTENTIONS OF RESPONDENT.

Briefly stated respondent's replies to petitioner's arguments are as follows (Numbered to correspond to petitioner's arguments):

1 & 2. Respondent replies to petitioner's arguments numbered 1 & 2 *supra* that the total net worth of petitioner must be used as the basis of determining New Jersey Taxable Net Worth. There is no provision in the act permitting part of the net worth to be excluded as net worth not employed in a financial business before the allocation for New Jersey Taxable Net Worth is made.

3. Respondent answers petitioner's argument numbered 3 *supra* by stating that N. J. S. A. 54:10B-5 gives the respondent authority to determine the fair value of the

components of net worth. Respondent accepted the values set forth in the books of subsidiaries as representing the fair value of the stocks of such subsidiaries owned by the parent.

4. In response to petitioner's argument numbered 4 (a) (b) and (c) *supra* respondent urges that under N. J. S. A. 54:10B-8 the method of allocating the net worth of a corporation doing a financial business in more than one state is clear and mandatory and that method was employed in making the redeterminations appealed from in this case.

5. In answer to petitioner's argument numbered 5 *supra* respondent simply states that the Division of Tax Appeals has no authority to pass on the constitutionality of an act of the Legislature of the State of New Jersey.

6. To petitioner's argument numbered 6 *supra* respondent replies that N. J. S. A. 54:10B-1 *et seq.* directs the method of allocation of net worth, giving respondent no discretion in making such allocation and that he followed strictly the provisions of said act in making the allocations in this case.

7. Respondent answers petitioner's argument numbered 7 *supra* by urging that N. J. S. A. 54:10B-10 authorizes respondent at his discretion to adjust the allocation of net worth only when it appears to him that the taxpayer maintains places of business outside of New Jersey for the purpose of evading taxes. Since this was not found to exist in this case, respondent had no authority to use any of the alternate methods proposed by petitioner for computing its tax.

8. It does not appear that respondent specifically replied to petitioner's argument numbered 8 *supra*.

Appendix B.

Questions Involved.

The questions required to be answered herein are seven in number and may be concisely stated as follows:

1. Is the Financial Business Tax Law (N. J. S. A. 54: 10B-1 *et seq.*) in violation of the Constitution of the United States?

2. Did respondent in making the redetermination of petitioner's taxes for the years in question exercise any discretion permitted by the statute in such a manner so as to violate the Constitution of the United States?

3. Does N. J. S. A. 54:10B-1 *et seq.* permit a taxpayer to exclude from its net worth investments in subsidiaries or in headquarters property located outside New Jersey?

4. Did respondent under N. J. S. A. 54:10B-1 *et seq.* have authority to increase the net worth, as reported by petitioner, to include the excess of the fair value of its assets over the amount reported in respect thereto?

5. Did respondent comply with the provisions of N. J. S. A. 54:10B 1 *et seq.* in computing petitioner's allocation factor?

6. May the respondent, at his discretion use some alternative method of allocation to determine taxable net worth, and if so, which method should be used?

7. Has petitioner been subjected to double taxation because its advances to its subsidiaries doing business in New Jersey were included once in its total net worth and again in the net worth of the subsidiary, and if so, is it entitled to an adjustment of its taxes?

Appendix B.

After studying the transcript of the record and the briefs submitted by the parties as well as the pertinent statute and cited cases, the Division has reached the following conclusions with respect to the foregoing questions.

The answer to the first question is simple and clear. The Division of Tax Appeals has no jurisdiction to determine the constitutionality of an act of the legislature. Hence, for the purposes of this decision, we are bound to accept N. J. S. A. 54:10B-1 *et seq.* as constitutional. See *Schwartz* v. *Essex County Board of Taxation*, 129 N. J. L. 129 (Sup. Ct. 1942), aff'd. 130 N. J. L. 177 (E. & A. 1943).

With respect to the second question we conclude that it must be answered in the negative. The only area in which respondent exercised his discretion was that permitted by N. J. S. A. 54:10B-5 and this he did in clear accord with the terms thereof. A more extended discussion of this will appear later herein in answer to question 4.

The third question—Does N. J. S. A. 54:10B-1 *et seq.* permit a taxpayer to exclude from its net worth investments in subsidiaries or in headquarters property located outside New Jersey?—must also be answered in the negative. N. J. S. A. 54:10B-3 provides, "There is hereby imposed upon every * * * corporation doing a financial business in this State an annual excise tax * * * upon its net worth, less the deductions hereinafter allowed, * * *." N. J. S. A. 54:10B-6 sets forth the deductions allowed as follows: "For the purpose of determining the measure of the tax hereunder, there may be deducted from net worth: (a) The average aggregate value of the following items held by a taxpayer during a tax year: (1) Shares of stock taxable under the bank stock tax; (2) Shares of stock in domestic insurance companies; (3) Shares of stock in railroad or other public utilities or in corporations taxable under this

act * * *". Obviously the taxpayer's net worth means entire net worth reduced only by the enumerated deductions. None of said enumerated deductions can be construed to include a deduction from total net worth of any portion thereof attributable to investment in subsidiaries or headquarters assets located outside the State of New Jersey, except to the extent of that portion of subsidiaries net worth which may be taxed under this statute.

The fourth question—Did respondent under N. J. S. A. 54:10B-1 *et seq.* have authority to increase the net worth, as reported by petitioner to include the excess of the fair value of its assets over the amount reported in respect thereto?—must be answered in the affirmative.

While N. J. S. A. 54:10B-2 provides that the net worth shall be determined by "the aggregate of the values disclosed by the books of the corporation * * *", N. J. S. A. 54:10B-5 provides:

> "'If in the opinion of the commissioner, the taxpayer's books do not disclose fair valuations the commissioner may require any additional information which may be necessary for a reasonable determination of the net worth which, in his opinion, would reflect the fair value of the assets carried on the books of the taxpayer, in accordance with sound accounting principles, and such determination shall be used as net worth for the purpose of this act."

Pursuant to the clear authority granted respondent by the foregoing provisions he determined that petitioner's books did not reflect the fair value of its stock in subsidiaries and so he adjusted the same to equal the value thereof as disclosed by the books of the respective subsidiary. In so doing respondent accepted such values on subsidiaries' books as being equivalent to the fair value of the respective individual assets owned by the subsidiaries.

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Appendix B.

Where a parent owns one hundred per cent of the stock of a subsidiary, the fair value of all the assets of the subsidiary, less, of course, the liabilities, is an accepted manner of determining the fair value of the asset represented by the ownership of all the subsidiary's stock. Petitioner has not shown that such method is not in accordance with sound accounting principles or that the amount used was actually in excess of fair value.

The fifth question—Did respondent comply with the provisions of N. J. S A. 54:10B-1 *et seq.* in computing petitioner's allocation factor?—must likewise be affirmatively answered.

The provisions of N. J. S. A. 54:10B-8 are applicable to this question and the pertinent parts thereof are as follows:

> "A taxpayer doing business in more than one State • • • shall allocate the value of its net worth (after allowable deductions) within this State, which allocated value shall be the measure of its tax pursuant to this act, according to the proportion of its gross business in this State to its gross business everywhere during the tax year, determined as the sum of:
>
> (a) Fees, commissions or other compensation for financial services rendered within this State;
>
> (b) (Not applicable in this case)
>
> (c) Interest and dividends received on loans, stocks, bonds and other securities managed within this State;
>
> (d) Interest charged to customers, at places of business maintained within this State • • •; and

(e) Any other gross income resulting from the operation of financial business within this State;

divided by the aggregate amount of such items of the taxpayer everywhere."

Now the petitioner complains that the dividends, interest and supervision fees received from its subsidiaries are not "gross business" within the meaning of the above quoted Section 8 and that respondent erred in including such income in determining its allocation factor. It has explained that all its subsidiaries are engaged in the same business as itself, i.e. "small loan business" and were organized for the purpose of engaging in such business where it was necessary or desirable that such business be carried on by a separate corporation. The dividends petitioner has received from its subsidiaries are part of such income.

Petitioner has shown that all its branch offices and subsidiaries forward to the home office their surplus funds, to the extent they exceed their needs to supply the demands of their customers. At the home office these funds are put into a pool, together with funds raised by petitioner from other sources. From this pool monies are supplied to branch offices and subsidiaries who require funds. Interest is charged on the funds supplied to subsidiaries.

With respect to the supervision fees petitioner has clearly established the extent of supervision it exercises through its home office in Chicago. A brief description of that supervisory activity has been set forth earlier herein. Needless to say petitioner through its headquarters office acts as the fully controlling head of the unitary type operation of its vast financial combine. The description of the function of petitioner's headquarters office contained in *Household Finance Corp.* v. *State Tax Commissioner*, 212 Md. 80, 128 Atl. 2d 640 (Ct. of Apps. 1957) is most accurate:

Appendix B.

"• • • Judgments, decisions and policies made and administered out of headquarters tie together and coordinate the activities of its many field offices. It is by the use of sound business judgment at the seat of management, that the life blood of a financial operation like the Household is channeled to those field functions requiring additional capital. Through the operation of its headquarters, and the combined borrowing power, which the complex gives thereto, the most advantages rates of interest may be attained with resultant benefit to all parts of the corporate body. • • • "

Therefore, on the basis of the established facts it must be concluded that amounts received as dividends, interest and supervision fees must be included in "gross business" within the meaning of Section 8. Certainly the dividends received on the stock of subsidiaries are "dividends received on • • • stock • • • ", and interest paid by the subsidiaries on funds advanced by the parent to be in turn loaned to customers of the subsidiaries and the fees paid by the subsidiaries for supervision as herein described are includible in "gross business" from "Fees, commissions or other compensations for financial services rendered • • •" or "Any other gross income resulting from the operation of financial business • • • ". They must all be included in "the aggregate amounts of *such items* of the taxpayer everywhere" (emphasis supplied). That is exactly what respondent did.

The sixth question—May the respondent, at his discretion use some alternative method of allocation to determine taxable net worth, and if so, which method should be used?—arises because of petitioner's contention that N. J. S. A. 54:10B-10 should be repunctuated and so con-

strued as to mean that respondent, in every case where a taxpayer maintains a place of business outside this State, may, in his discretion and in such manner as he may determine, adjust items of net worth, gross business within and without the State and the allocation of net worth as may be necessary for a true and correct determination of the tax. The difficulties with this argument are two in number. First; the section should be read as a whole and with or without commas, the manifest intent was to provide the Director with complete discretion to act whenever it appeared to him that a taxpayer was maintaining a place of business outside the State or doing certain other things for the purpose of evading tax under this act. Only then may he use his discretion to adopt an alternative method of allocation. Plainly the legislature intended that the method of allocation provided in the act was proper and sufficient in all cases except, however, in the case where improper evasion occurred. When that appeared to exist, it then gave the Director broad powers to meet it. Such is not the case here and this section is for that reason inapplicable.

Even if, however, we were to construe it in the fashion urged by petitioner, whether or not such alternative allocation was to be used was a discretionary matter with the Director and we are not sufficiently impressed with petitioner's arguments to find that respondent's failure to exercise that discretion in this case is an abuse of that discretion or resulted in the assessment of an unconstitutional tax.

Finally in answer to the seventh question—Has petitioner been subjected to double taxation because its advances to its subsidiaries doing business in New Jersey were included once in its total net worth and again in the net

worth of the subsidiary?—it must be observed that N. J. S. A. 54:10B-6 provides, in computing net worth, that the taxpayer may exclude from its own net worth a proportion of the value of stock in other corporations subject to tax under this act. There is no provision for a similar adjustment with respect to advances to such corporations. Accordingly, there would be no basis, under the statute, for making such an adjustment and neither the Director nor the Division of Tax Appeals is at liberty to supply such a provision. Any relief in this regard, if needed, must come from the legislature.

In view of the conclusion that such advances may not be adjusted under the statute no relief on this score could be given to petitioner, but it should be pointed out that no competent evidence was offered to prove that the subsidiaries doing business in New Jersey actually had included in their net worth the advances made by petitioner.

Now, in brief summary, the Division finds that the redetermination, as corrected by the minor adjustments pertaining to the exclusion from petitioner's net worth of that part of the value of net worth attributable to subsidiaries doing business in New Jersey which was agreed to by the parties, must be affirmed for the reason that respondent computed the same in accordance with the clear mandate of the Financial Business Tax Law. N. J. S. A. 54:10B-1 *et seq.* Having found that respondent followed the statute as he was required thereby to do, no constitutional question arises which the Division of Tax Appeals has jurisdiction to decide. No consideration, therefore, has been given to the constitutionality of the statute.

Judgment may be submitted in accordance with this opinion.

Appendix B.

Judgment.

STATE OF NEW JERSEY

DEPARTMENT OF THE TREASURY

DIVISION OF TAX APPEALS

HOUSEHOLD FINANCE CORPORATION, A Delaware corporation, Petitioner, *vs.* DIRECTOR OF THE DIVISION OF TAXATION, Respondent.	Judgment

Petitioner having appealed from the determination of the Director of the Division of Taxation redetermining the tax liability of the petitioner under the Financial Business Tax Law for the years 1954 through 1957, and the matter having come on for hearing before Ellis M. Kopp, a member of the Division of Tax Appeals, and good cause therefor appearing,

IT IS ON this 6th day of March 1961 ORDERED AND ADJUDGED that the said determination of the Director of the Division of Taxation, subject to adjustments thereto, to be made upon the filing by the petitioner of claims for deductions for subsidiaries as provided by N. J. S. A. 54:10B-1, *et seq.* and in accordance with the Opinion of the Division of Tax Appeals filed herein, be and the same is hereby affirmed.

DIVISION OF TAX APPEALS

By ELLIS M. KOPP /s/
ELLIS M. KOPP

Appendix C.

New Jersey Financial Business Tax Law (1946), as Amended.

(Quoted Excerpts from N. J. S. A. 54:10B-1, *et seq.*)

"54:10B-2. *Definitions*

"For the purposes of this act, unless the context otherwise requires:

"(a) 'Commissioner' shall mean the director of the division of taxation of the State Department of Taxation and Finance.

"(b) 'Financial business' shall mean all business enterprise which is (1) in substantial competition with the business of national banks and which (2) employs moneyed capital with the object of making profit by its use as money, through discounting and negotiating promissory notes, drafts, bills of exchange and other evidences of debt; buying and selling exchange; making of or dealing in secured or unsecured loans and discounts; dealing in securities and shares of corporate stock by purchasing and selling such securities and stock without recourse, solely upon the order and for the account of customers; or investing and reinvesting in marketable obligations evidencing indebtedness of any person, copartnership, association or corporation in the form of bonds, notes or debentures commonly known as investment securities; or dealing in or underwriting obligations of the United States, any State or any political subdivision thereof, or of a corporate instrumentality of any of them. This shall include, without limitation of the foregoing businesses commonly known as industrial banks, dealers in commercial paper and acceptances, sales finance, personal finance, small loan and mortgage financing businesses, as well as any other enter-

prise employing moneyed capital coming into competition with the business of national banks; *provided*, that the holding of bonds, notes, or other evidences of indebtedness by individual persons not employed or engaged in the banking or investment business and representing merely personal investments not made in competition with the business of national banks, shall not be deemed financial business. Nor shall 'financial business' include national banks, production credit associations organized under the Farm Credit Act of 1933, stock and mutual insurance companies duly authorized to transact business in this State, security brokers or dealers or investment companies or bankers not employing moneyed capital coming into competition with the business of national banks, or any of the following entities organized under the laws of this State: credit unions, savings banks, savings and loan and building and loan associations, pawnbrokers, and State banks and trust companies.

"(c) 'Net worth' shall mean:

"(1) In the case of a corporation—the aggregate of the values disclosed by the books of the corporation for (1) issued and outstanding capital stock, (2) paid-in or capital surplus, (3) earned surplus and undivided profits, (4) surplus reserves which can reasonably be expected to accrue to holders or owners of equitable shares, excluding reasonable valuation reserves and (5) the amount of all indebtedness owing directly or indirectly to holders of ten per centum (10%) or more of the aggregate outstanding shares of the taxpayer's capital stock of all classes, as of the close of a tax year.

* * * * * *

"54:10B-3. *Excise tax imposed*

"There is hereby imposed upon every person, copartnership, association and corporation doing a financial busi-

ness in this State, an annual excise tax, payable in the year one thousand nine hundred and forty-six and in each year thereafter, at the rate of three-fourths of one per centum (¾ of 1%) upon its net worth, less the deductions hereinafter allowed, as of the close of the preceding calendar year, but in no event less than twenty-five dollars ($25.00). Such tax shall also be in lieu of any State franchise tax or of any State or local taxation of, upon or measured by personal property entering into the determination of net worth.

"54:10B-6. *Determining measure of tax; deductions*

"For the purpose of determining the measure of the tax hereunder, there may be deducted from net worth:

"(a) The average aggregate value of the following items held by a taxpayer during the tax year:

"(1) Shares of stock taxable under the bank stock tax;

"(2) Shares of stock in domestic insurance companies;

"(3) Shares of stock in railroads or other public utilities or in corporations taxable under this act; but only in the same proportion that the issuing corporation's total net worth, income or gross receipts, enters into the determination of a tax base under this or any other law of this State;

less such proportion of the total liabilities of the taxpayer (as of the close of the tax year) as the ratio of such average aggregate value to total assets of the taxpayer (as of the close of the tax year); *provided, however,* that, notwithstanding the foregoing, the average aggregate value of any shares of stock described in (1), (2) or (3) held by a taxpayer for more than five years prior to the tax year may be fully deducted from net worth; *and provided further,* that no deduction shall be made or permitted for any shares of

stock described in (1), (2) or (3) above where any indebtedness has been incurred with the intent or for the purpose of acquiring, holding or controlling such stock.

"(b) There may also be deducted from net worth the assessed value of real estate taxable in this State; but such deduction shall not exceed the amount of the taxpayer's equity in such real estate which is included in net worth.

"54:10B-7. *Subsidiary subject to the tax; amount*

"For the purpose of this section, a subsidiary shall be deemed to be any corporation subject to the corporation business tax act in which a taxpayer is the beneficial owner of at least eighty per centum (80%) of the total combined voting power of all classes of stock entitled to vote and of at least eighty per centum (80%) of the total number of shares of all other classes of stock except nonvoting stock which is limited and preferred as to dividends. In determining the measure of the tax imposed by this act, a taxpayer may deduct from its net worth such proportion, not exceeding fifty per centum (50%) of the average value during the tax year of its holdings of capital stock of a subsidiary, less net liabilities (if any) to the subsidiary, as the ratio of the subsidiary's taxable net worth in the tax year (under the corporation business tax act) to its entire net worth.

"54:10B-8. *Corporation doing business in more than one state; allocating value of net worth*

"A taxpayer doing business in more than one State directly or through a wholly-owned subsidiary having capital stock with a par value or stated value of five thousand dollars ($5,000.00) or less shall allocate the value of its net worth (after allowable deductions) within this State, which

allocated value shall be the measure of its tax pursuant to this act, according to the proportion of its gross business in this State to its gross business everywhere during the tax year, determined as the sum of:

"(a) Fees, commissions or other compensation for financial services rendered within this State;

"(b) Gross profits from trading in stocks, bonds, or other securities managed within this State;

"(c) Interest and dividends received on loans, stocks, bonds and other securities managed within this State;

"(d) Interest charged to customers, at places of business maintained within this State, for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying such accounts; and

"(e) Any other gross income resulting from the operation of financial business within this State;

divided by the aggregate amount of such items of the taxpayer everywhere.

* * * * * *

"54:10B-10. *Evading tax; power of commissioner to determine tax*

"Whenever it shall appear to the commissioner that any taxpayer maintains a place of business outside this State, or that any agreement, understanding or arrangement exists between a taxpayer and any corporation, person or firm, for the purpose of evading tax under this act, or whereby the activity, business, receipts or net worth of the taxpayer is distorted for such purpose, the commissioner

may in his discretion and in such manner as he may determine, adjust items of net worth, gross business within and without the State and the allocation of net worth, or make such other adjustments in any tax report or tax return as may be necessary for a true and correct determination of the tax pursuant to this act. The commissioner may require any person or corporation to submit information under oath, or to permit examination of its books, papers and documents, as may be necessary to enable him to determine the existence, nature or extent of an agreement, understanding or arrangement to which this section relates, whether or not such person or corporation is subject to the tax imposed by this act.

Appendix D.

Excerpts from Appellant's Main Brief Filed in Supreme Court of New Jersey.

SUPERIOR COURT OF NEW JERSEY

APPELLATE DIVISION.

DOCKET NO. A-532-60.

HOUSEHOLD FINANCE CORPORATION, a Delaware Corporation, Appellant, *vs.* DIRECTOR OF THE DIVISION OF TAXATION, Respondent.	Civil Action On Appeal from Judgment of Division of Tax Appeals, State Department of Taxation and Finance. Sat Below: Kopp, Member.

• • • • • •

STATEMENT OF QUESTIONS INVOLVED.

1. Did the tax base of purported local net worth upon which appellant's financial business tax liability was computed include extraterritorial values not within New Jersey's jurisdiction to tax?

2. Was the tax base inaccurately and unfairly computed so as to be excessive?

3. Did the financial business tax act require such result, or could it be interpreted to reach a fair and constitutional result?

4. Did the act as applied to appellant deprive appellant of due process of law and equal protection of the laws?

• • • • • •

Appendix D.

CONCLUSION.

If New Jersey has conferred any opportunity, benefits, sanction or protection upon the values represented by taxpayer's headquarters or subsidiary investment as such, the record certainly does not show it and the Attorney General made not even a pretense of proving it. At the risk of tedium, it must be repeated that the record shows and the Director concedes the exact opposite: These values are foreign to New Jersey, they are extraterritorial, the assets are without exception located outside New Jersey, New Jersey has not created or protected the right of a Delaware corporation to own and manage in Illinois (chiefly) headquarters assets and share capital of corporations doing a local business in Maryland, Maine, etc. Nevertheless, New Jersey has taxed these extraterritorial values. Direct proof of this fact is reviewed at length in Point I. New Jersey's tax base is much bigger than it would be under the application of any other sound allocation principle; its allocation method is theoretically unsound; and its seizure of extraterritorial values at the direct expense of the other states is proven empirically, theoretically, algebraically, and by direct uncontroverted testimony.

This harsh, illogical and burdensome result is not required by the taxing statute. There is ample room to interpret the statute fairly, or to mold its literal terms. Point II.

If there were not room to interpret or mold the statute, then it would have to be held to be an unconstitutional deprivation of due process and equal protection of the laws, Point III.

Taxpayer urges that the Court set aside the Director's redeterminations, as affirmed by the Division of Tax Appeals, of its Financial Business Tax Liability for the

tax years 1954, 1955, 1956 and 1957 as violative of the spirit and true construction of the Financial Business Tax Act and contrary to constitutional principles of due process and equal protection of the laws; and that it remand the case in order to reassess Taxpayer's true and just liability for those years by recomputing the tax on the basis of a proper method of allocation.

Respectfully submitted,

PETERS, HARDIN & WARD,
Attorneys for Appellant.

ROGER C. WARD,
FLOYD E. BARTON,
of the Illinois Bar
of Counsel

Appendix E.

Excerpts from Appellant's Petition of Appeal Filed in Division of Tax Appeals, State of New Jersey.

DEPARTMENT OF THE TREASURY

DIVISION OF TAX APPEALS

HOUSEHOLD FINANCE CORPORATION, a Delaware corporation, Petitioner, vs. DIRECTOR OF THE DIVISION OF TAXATION, Respondent.	On Appeal from Redetermination and Assessment of Financial Business Tax Liability for 1954, 1955, 1956 and 1957

Petitioner Household Finance Corporation (hereinafter called the "Taxpayer") appeals to the Division of Tax Appeals from the redetermination of its tax liability under the Financial Business Tax Law (1946), N. J. S. A. 54:10B-1 et seq., made by respondent Director of the Division of Taxation, Department of the Treasury, State of New Jersey, (hereinafter called the "Director"), for the years 1954, 1955, 1956 and 1957; and respectfully shows that: • • •

22. Therefore, Taxpayer petitions for a judgment with respect to Taxpayer's tax liability for the tax-payment years 1954, 1955, 1956 and 1957 under the New Jersey Financial Business Tax Law (1946), [N. J. S. A. 54:10B-1 *et seq.*], as follows:—

A. Sustaining Taxpayer's appeal from those adjustments and redeterminations by the Bureau and by said Director of the Division of Taxation, which Taxpayer has protested and hereby protests as set forth above;

B. Setting aside those adjustments and redeterminations which the Bureau and the Director made, and which Taxpayer has protested and hereby protests, as set forth above;

C. Adjudging and declaring that Taxpayer is entitled to refunds aggregating not less than the $55,498.52 total amount of additional taxes and interest thereon, which Taxpayer paid with respect to said 4 years, as set forth above; and that Taxpayer is also entitled to refunds of such additional amounts of taxes and interest paid by it, as shall be determined and adjudged to have been paid by it in excess of the lawful and proper amounts of Taxpayer's tax liability for said 4 years, under the Statute as correctly and lawfully construed and applied in accordance with the Statute's provisions and the requirements of Section 1 of the Fourteenth Amendment of the Constitution of the United States of America;

D. Adjudging and declaring that, with respect to this Taxpayer and the 4 tax-payment years in question, the Statute, and the adjustments and redeterminations with respect to Taxpayer's tax liability thereunder, which the Bureau and the Director made purportedly under and in accordance with the Statute, are unlawful and unconstitutional, in that the same deprived and deprive Taxpayer of its property without due process of law, and deprived and deprive Taxpayer of the equal protection of the laws, all contrary to Section 1 of the Fourteenth Amendment of the Constitution of the United States of America, because:

(i) A New Jersey financial business tax was imposed upon Taxpayer in respect to values representing property of Taxpayer located outside the territroial limits and taxing jurisdiction of New Jersey; and also

(ii) Such taxes were imposed upon Taxpayer with respect to values wholly unrelated to the true value of Taxpayer's New Jersey financial-business enterprise and franchise; and

E. Granting Taxpayer such other and further relief as may be lawful and proper.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 237

HOUSEHOLD FINANCE CORPORATION,

Appellant,

vs.

DIRECTOR OF THE DIVISION OF TAXATION, DEPARTMENT OF THE TREASURY OF THE STATE OF NEW JERSEY,

Respondent.

On Appeal from the Supreme Court of New Jersey

MOTION TO DISMISS, BRIEF AND APPENDIX IN SUPPORT THEREOF

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Dated: AUGUST 7, 1962.

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IN THE

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No.

HOUSEHOLD FINANCE CORPORATION,

Appellant,

vs.

DIRECTOR OF THE DIVISION OF TAXATION, DEPARTMENT OF THE TREASURY OF THE STATE OF NEW JERSEY,

Respondent.

On Appeal from the Supreme Court of New Jersey

Motion to Dismiss

Pursuant to Rule 16(b) of this Court, the Attorney General of the State of New Jersey, on behalf of the State of New Jersey, moves to dismiss this appeal on the ground that it does not present a substantial Federal question.

Opinions Below

The opinion from which appellant appeals to this Court is that of the Supreme Court of New Jersey entered January 22, 1962, reported in 36 N. J. 353, 177 A. 2d 738 (1962). The Supreme Court of New Jersey denied a petition for rehearing on March 26, 1962.

Questions Presented

1. Does the allocation of the net worth of a multi-state small loan finance business, for purposes of a state franchise tax, in accordance with an apportionment formula based upon a comparison of gross receipts within the taxing state to gross receipts everywhere, constitute a palpably unreasonable method of tax apportionment contrary to the due process clause of the 14th Amendment?

2. Does the inclusion in the denominator of a gross receipts apportionment formula (constituting total gross receipts) of the receipts of the appellant derived directly from small loan customers, together with appellant's receipts consisting of dividends, interest and fees paid to it by wholly-owned subsidiary corporations engaged in the same small loan finance business, without the inclusion of the gross receipts of the subsidiary corporations from their small loan customers, constitute a violation of the 14th Amendment because the investment in the subsidiary corporations is included as an asset in the computation of appellant's total net worth.

3. Has the appellant raised a substantial Federal question when it has failed to demonstrate that the proportion of its net worth allocated to New Jersey in accordance with the New Jersey statute is "palpably disproportionate" to the value of its local privilege or franchise?

Statement of the Case

A. Nature of Appellant's Business.

The appellant, Household Finance Corporation, conducts a multi-state small loan finance business throughout the United States and in Canada. It operates this small loan finance business in the State of New Jersey. It is admittedly subject to the New Jersey Financial Business Tax

Law (1946), N.J.S.A. 54:10B-1 *et seq.* This statute has been summarized by appellant in its Jurisdictional Statement and the pertinent provisions are set forth therein.

The appellant conducts its business through branch offices as well as subsidiary corporations and in the tax years in question, 1954 to 1957, inclusive, it maintained between 417 and 445 branch offices in the United States, of which 17 were in New Jersey. It also owned subsidiary corporations which in the United States totaled 24 as of the end of 1953 and numbered 155 by the end of 1956. There were no subsidiaries in New Jersey in 1954; there were 2 in 1955; 7 in 1956; and 10 in 1957. Of these, 1 was active in 1956 and 4 in 1957. Its Canadian operations were conducted through subsidiary corporations.

Appellant also owned considerable sums of cash which it kept on hand, in banks and in transit. It also held accounts receivables, securities, office equipment and the like. These assets have been referred to as "headquarter assets" although its substantial sums of cash were consistently and continuously circulated throughout its entire nationwide enterprise.

In addition to the foregoing, appellant carried as an asset substantial advances to its subsidiaries for the purpose of providing these subsidiaries with funds for loans to the general public. Appellant also carried as an asset the loans or loan accounts which it made directly to small loan borrowers or customers.

Appellant's receipts or gross income consisted of the interest which it collected on its loans made to the general public through its numerous branch offices. From its subsidiary corporations the appellant received interest paid by the subsidiaries on the loans or advances made to them; it received dividends paid by the subsidiary corporations on capital stock; and appellant also received payments de-

nominated "supervision fees" paid by the subsidiary corporations for various administrative and related services rendered by appellant.

It is conceded that the appellant's business and operations were integrated and unitary (Resp. App. B, 6a). Appellant maintained centralized supervision, direction and control over its entire nationwide business, which control was exerted over branch offices as well as its subsidiary corporations. There was centralized administration and accounting. Corporate assets and funds were circulated throughout the enterprise, among both subsidiary offices and branch offices. Personnel and employees were likewise assigned throughout the entire enterprise and all of the branch offices and the subsidiary corporations utilized a name or title which identified them with the appellant, Household Finance Corporation.

B. Appellant's Tax Returns.

1. Net Worth.

For the tax years involved, appellant filed tax returns under the Financial Business Tax Law (1946), N.J.S.A. 54:1-B-1 *et seq.* In its returns, the appellant excluded from "entire net worth" its entire capital stock investment in and advances to its subsidiary corporations. Appellant did include, however, in the computation of net worth, subject to allocation, its so-called "headquarter assets".

2. Allocation Factor.

In determining the proportion of net worth to be allocated to New Jersey for tax purposes, appellant did not include in the denominator of the gross receipts fraction any receipts which appellant derived from its subsidiary corporations, these receipts consisting of interest, dividends and supervision fees.

C. The determination of tax liability by the State Director of the Division of Taxation.

1. Net Worth.

The State Director of the Division of Taxation made a redetermination of appellant's tax liability. So far as pertinent herein, the Director determined that the capital stock of and advances to appellant's subsidiary corporations should be considered as assets in the computation of total net worth and that the capital stock should be valued, not at cost per appellant's books, but according to the value disclosed by the books of the subsidiary corporations.

2. Allocation Fraction.

The Director determined that there be included in the denominator of the gross receipts allocation fraction the gross income received by appellant from its subsidiary corporations. This had the net effect of *decreasing* the allocation fraction for each of the years involved as originally reported by appellant in its tax returns. Thus, in 1954 appellant's allocation fraction was 5.88% compared with the Director's recomputation of 5.61%; in 1955 the appellant's fraction was 5.61% compared with the Director's 4.72%; in 1956 the appellant's was 5.31% compared with the Director's 4.38% and in 1957 the appellant's was 5.03% compared with the Director's 3.61%.

D. Appellant's contentions before the State Division of Tax Appeals.

The appellant appealed from the redetermination of the Director of Taxation to the State Division of Tax Appeals in accordance with the appropriate statute and regulations. Before the Division of Tax Appeals the appellant contended that its ownership of its subsidiary cor-

porations was not a part of its financial business but was "a holding-company business" (Resp. App. A, 1a). It contended that the receipts which it received from its subsidiary corporations were "an incident to [its] said holding-company business" (Resp. App. A, 1a-2a). Appellant contended that it was error on the part of the Director of Taxation to include its investment in subsidiary corporations as a part of net worth, and it further contended that the inclusion in net worth and the valuation of the capital stock by the State Director of Taxation amounted to a "consolidation" of appellant's net worth, which it protested (Resp. App. A, 2a). At the hearing, however, appellant indicated that it was proper to include the subsidiaries in net worth (Resp. App. B, 6a).

Appellant further complained that the allocation fraction as recomputed by the Director was erroneous because it excluded from the denominator of the gross receipts allocation fraction, the receipts of the subsidiary corporations from their small loan customers and it included with the receipts of appellant from its customers the payments received by the appellant from the subsidiary corporations consisting of dividends, interest and supervision fees. The appellant contended that this computation by the State Director mixed "consolidated factors with unconsolidated factors having no reasonable relationship to one another" (Resp. App. A; 3a-4a).

Appellant noted in its Petition of Appeal that the State Director had acceded to its demand that appellant be permitted to deduct from net worth a proportionate amount of the capital stock of appellant's subsidiary corporations which it operated in New Jersey during the tax years involved and which were themselves separately taxable under the statute (Resp. App. A, 4a). This deduction is authorized under N.J.S.A. 54:10B-6 (Appl. App. C, 38a-39a).

Additionally, appellant took the position that its so-called "headquarter assets" should be excluded from net worth because they were "located entirely outside New Jersey" (Resp. App. A, 4a-5a).

In its prayer for relief, appellant sought, among other things, to set aside the "adjustments and redeterminations" made by the State (Resp. App. A, 5a).

E. The Decision of the New Jersey Supreme Court.

The State Division of Tax Appeals affirmed the determination of the State Director of Taxation (Appl. App. B, 16a-35a). The appellant appealed from this judgment to the Superior Court, Appellate Division of New Jersey, and the New Jersey Supreme Court certified the appeal to it.

The Supreme Court of New Jersey held that the Financial Business Tax Law (1946) does not constitute an *ad valorem* property tax but is a tax upon the franchise to do a local finance business within the State of New Jersey; that the appellant's multi-state finance business was unitary in character and that the so-called "headquarter assets" were part of an operating whole utilized by the appellant throughout its entire nationwide operations, including those in New Jersey and, it was therefore proper to include such assets in the computation of net worth subject to allocation. The New Jersey Supreme Court also held that the allocation fraction computed by the Director was reasonable. It pointed out that the evidence proffered by appellant in the form of alternative allocation fractions did not indicate that the allocation fraction imposed by the statute was inappropriate or unreasonable or that the proportion of net worth actually allocated to New Jersey was "palpably disproportionate" to the value of appellant's local franchise. The Supreme Court further emphasized that while the appellant appeared to be arguing

that its subsidiary corporations should be "consolidated" for purposes of computing the allocation fraction, it nevertheless maintained that its subsidiary corporations operating within New Jersey remain "unconsolidated", *i.e.*, that the value of these subsidiary corporation be deducted from its net worth subject to allocation. The Supreme Court of New Jersey further stressed that the statute did not permit the filing of consolidated returns with respect to a taxpayer and affiliated or subsidiary corporations (with one minor exception) and that it was not unreasonable for the State to impose a tax upon a corporate taxpayer in accordance with its own corporate structure.

Summary of Argument

Appellant does not contend before this Court that it was improper to include in the computation of its net worth subject to allocation its so-called headquarter assets or its investment in subsidiary corporations. The inclusion of these assets, concededly an integral part of appellant's unitary business and operations, is unquestionably valid. *Ford Motor Co. v. Beauchamp*, 308 U. S. 331, 60 S. Ct. 273, 84 L. Ed. 304 (1939) *rehearing denied* 308 U. S. 640, 60 S. Ct. 273, 84 L. Ed. 531 (1940).

Appellant's contentions revolve about the allocation formula prescribed by the New Jersey statute and applied by the State Director of the Division of Taxation. Its contentions are twofold. It argues that the allocation formula based upon gross receipts is bad because there is included in net worth the so-called "headquarter assets" which, appellant alleges, do not "directly" produce revenues themselves; therefore, appellant alleges the allocation formula "disregards headquarters values" and "mismeasures the portion of * * * net worth reflecting non-revenue producing headquarters" (see pages 8, 9 of appellant's Juris-

dictional Statement). Appellant also argues that the allocation formula is bad because there is not included in the denominator thereof, consisting of appellant's total gross receipts, the direct receipts earned by the subsidiary corporations. In effect, appellant alleges this "penalizes the use of corporate subsidiaries" and "mismeasures the portion of net worth reflecting the full net value of appellant's investment in wholly-owned subs which themselves receive gross receipts" (see pages 8, 9 of appellant's Jurisdictional Statement).

The State of New Jersey argues herein that the statutory allocation fraction whereby the net worth of a multi-state taxpayer engaged in a financial business in New Jersey is apportioned to New Jersey for tax purposes by a comparison of the gross receipts earned in New Jersey with gross receipts earned everywhere is appropriate and is reasonably calculated to allocate to New Jersey a fair proportion of total net worth, and that the reasonableness of an apportionment formula based upon gross receipts has been recognized and upheld by many courts including the Supreme Court of the United States. It is further argued herein that the computation of the proportion of the appellant's net worth to be allocated or apportioned to New Jersey for tax purposes by a fraction which includes in the denominator thereof the receipts which the appellant received from its subsidiary corporations was in accordance with the clear provisions of the statute and was reasonable; and that the exclusion from the denominator of the gross receipts of the subsidiary corporations derived from their direct operations was likewise in accordance with the statute which does not, in this instance, sanction consolidated returns, and was consistent with the corporate structure of appellant's enterprise and was not unreasonable. Finally, it is argued that the appellant has not by "clear and cogent evidence" demonstrated that any other alloca-

tion fraction based upon other factors or its own separate system of accounting was necessarily more reasonable in determining the proportionate amount of its net worth which should be allocated to New Jersey for tax purposes, and that the actual proportion of net worth allocated to New Jersey by the statutory gross receipts formula did not result in a "palpably disproportionate" attribution of net worth to New Jersey for tax purposes.

For these reasons it is respectfully submitted that the appellant has raised no substantial federal question which would warrant this appeal and that the appeal should, therefore, be dismissed.

ARGUMENT

POINT I

The apportionment of the net worth of a financial business for franchise tax purposes by means of an allocation formula predicated upon a comparison of the gross receipts of the taxpayer constitutes a reasonable method of apportionment and is not violative of the Fourteenth Amendment.

The method employed by the New Jersey Financial Business Tax Law (1946), N.J.S.A. 54:10B-1 *et seq.* for determining the proportion of a subject taxpayer's net worth which should be allocated to the State of New Jersey for tax purposes is based upon a comparison between the amount of business done in New Jersey with the amount of business done everywhere. The statute defines this allocation fraction as the taxpayer's gross receipts arising from its New Jersey business divided by its gross receipts arising from its business done everywhere. N.J.S.A. 54:10B-8. The only constitutional question with respect to the

use of a particular allocation fraction is whether or not it is reasonably designed and calculated to apportion to the taxing state a fair proportion or amount of a taxpayer's total net worth.

The utilization of an apportionment formula based upon gross receipts has been recognized as valid by this Court. In *Ford Motor Co. v. Beauchamp, supra*, this court held that the use of a gross receipt's allocation fraction for the purpose of apportioning total net worth is constitutionally sound. In this case, Texas imposed an "annual franchise tax on all corporations chartered or authorized to do business in Texas, measured by a graduated charge upon such proportion as the out-standing capital stock, surplus and undivided profits of the corporation, plus its long-term obligations, as the gross receipts of its Texas business bear to the total gross receipts of its entire business". Thus, the subject matter of the Texas tax was the same as that of the New Jersey Financial Business Tax Law (1946), *i.e.*, the privilege of doing an intrastate business within the taxing state. Moreover, the measure of the Texas tax was identical with that of the New Jersey tax, *i.e.*, net worth apportioned to the taxing state in proportion to gross receipts. The taxpayer's gross receipts from business done in Texas during the year in question amounted to approximately $34,000,000.00; its total gross receipts were approximately $888,000,000.00. Thus, the ratio of Texas receipts to total receipts was approximately 3.85%. The taxpayer's total taxable capital was $600,000,000. Consequently, the statutory formula allocated to Texas a tax base in excess of $23,000,000.00. The value of the taxpayer's assets physically located within Texas was only somewhat over $3,000,000.00.

Ford Motor Co. advanced the same arguments presented by appellants herein, namely, that the tax as assessed de-

prived it of its property without due process of law because it was a tax upon property neither located nor used within the State of Texas and activities conducted beyond the borders of Texas *i.e.*, that it was a tax upon "extra territorial values". This Court rejected these contentions, stating:

> "The statute calls the excise a franchise tax. It is obviously payment for the privilege of carrying on business in Texas. There is no question but that the State has the power to make a charge against domestic or foreign corporations for the opportunity to transact this intrastate business. The exploitation by foreign corporations of intrastate opportunities under the protection and encouragement of local government offers a basis for taxation as unrestricted as that for domestic corporations. In laying a local privilege tax, the state sovereignty may place a charge upon that privilege for the protection afforded. When that charge, as here, is based upon the proportion of the capital employed in Texas, calculated by the percentage of sales which are within the state, no provision of the Federal Constitution is violated." 308 U. S. at pp. 334, 335; 60 S. Ct. at p. 275; 84 L. Ed. at pp. 305, 306.
>
> "In a unitary enterprise, property outside the state, when correlated in use with property within the state, necessarily affects the worth of the privilege within the state. Financial power inherent in the possession of assets may be applied, with flexibility, at whatever point within or without the state the managers of the business may determine. For this reason it is held that an entrance fee may be properly measured by capital wherever located. The weight, in determining the value of the intrastate privilege, given the property beyond the state boundaries is but a recognition

of the very real effect its existence has upon the value of the privilege granted within the taxing state," 308 U. S. at p. 336; 60 S. Ct. at p. 276; 84 L. Ed. 306, 307.

The *Beauchamp* case does not stand alone as a decision recognizing the validity of utilizing an allocation fraction based upon receipts. Other decisions have upheld the propriety of a gross receipt's allocation formula for tax purposes. E.G. *Railway Express Agency* v. *Virginia*, 358 U. S. 434, 79 S. Ct. 411, 3 L. Ed. 2d 450 (1959); *Smoot Sand & Gravel Corp.* v. *District of Columbia*, 261 F. 2d 758 (D. C. Cir. 1958), *cert. denied* 359 U. S. 968, 79 S. Ct. 876, 3 L. Ed. 2d 834 (1959); *Ford Motor Co.* v. *Oklahoma Tax Commission*, 188 Okla. 78, 106 P. 2d 803 (Sup. Ct. 1940); *Household Finance Corp.* v. *State Tax Com'n*, 217 Md. 327, 142 A. 2d 807 (Ct. of App. 1958); *Virginia Electric and Power Company* v. *Currie*, 254 N. C. 17, 118 S. E. 2d 155 (Sup. Ct. 1961), *appeal dismissed* 367 U. S. 910, 81 S. Ct. 1919, 6 L. Ed. 2d 1250 (1961).

In contending that the statutory gross receipts allocation formula is inappropriate to allocate its net worth, appellant disregards completely the crucial and important fact that the statute applies to business entities conducting a financial business within the State of New Jersey. It has been recognized that the tax base of a general or ordinary business corporation may be apportioned or allocated for franchise tax purposes in accordance with formulae based upon several combined factors or items. Thus, states have frequently employed allocation formulae consisting of property, payroll and receipts in such circumstances. E.g. *Butler Bros.* v. *McColgan*, 315 U. S. 501, 62 S. Ct. 701, 86 L. Ed. 991 (1942); *Cleveland-Cliffs Iron Co.* v. *Michigan Corp. & Sec. Com'n*, 351 Mich. 652, 88 N. W. 2nd 564 (Sup. Ct. 1958). Indeed, the State of New Jersey in determining the measure of the franchise tax upon gen-

eral business corporations provides for allocation in accordance with a ratio or fraction consisting of tangible property, receipts, and payrolls or in the alternative (where such a fraction would be greater), one based upon tangible and intangible assets. N.J.S.A. 54:10A-5(b), 6. It does not follow, however, that the utilization of an allocation fraction based upon gross receipts is inappropriate or not reasonably designed to effect a fair and sensible apportionment of the net worth of a financial business.

The Legislature of the State of New Jersey in enacting the Financial Business Tax Law (1946) followed the recommendations of a special committee which studied the overall problem of taxing monied capital in competition with national banks. The history of this legislation is set forth in *Morris & Essex Investment Co.* v. *Director of Division of Taxation*, 33 N. J. 24, 161 A. 2d 491 (1960) and is alluded to by the New Jersey Supreme Court in its decision below. The findings and recomendations which served as a basis for the Financial Business Tax Law (1946) are set forth in the First Report of this committee wherein it was stated:

> "The application of the proposed capital stock tax to corporations of this and other states requires a method of identifying that portion of the capital value to be used as a measure of the tax. This problem has not arisen in the bank stock tax for the reason that banks are not authorized to maintain a place of business outside the county of their principal office. It need hardly be noted that competing moneyed capital is not so restricted, and in fact, corporations which may and do operate on a national basis are a principal source of competition. Both tax law and sound policy require that this characteristic of the competing business be recognized in the proposed legislation."

> "The selection of a method of allocation depends upon the type of tax with which it will be used. If

the proposed tax were deemed to be a property tax, the matter of allocation would be reduced to the simple proposition that the State may constitutionally tax only such property as may be found within the State. Such situs determination for the purposes of a capital stock tax would at least find deductions for all tangibles located outside the State, for all Federal government securities (as immune from taxation) and for all other items of property (e.g. municipal obligations) which State policy might desire to leave free of a capital levy. These deductions would apply to a domestic corporation. Foreign corporations could be subject to a measure including only that proportion of their capital employed within the State.

"Under an excise tax measured by capital, as proposed, there is considerably more freedom to achieve a working equality of treatment as among the various classes of taxpayers, foreign and domestic corporations and unincorporated business. In the State's general business tax—what is known as 'the corporate net worth tax'—there are similar considerations and the so-called Massachusetts formula was adopted. This formula allocates by using an average of three factors, payroll, tangible property, gross receipts, in and out of the State. In the case of a business where one or more of these factors may be practically inapplicable, it may be omitted. Financial business is a principal instance of this kind.

"It is inherent in financial business that neither payroll nor tangible property should ordinarily be revelant factors in a determination of the location or amount of capital employed. The Supreme Court has clearly described the business involved for present purposes as an enterprise in which the capital em-

ployed is money, where the object of the business is the making of profit by its use as money, such as investment and reinvestment in securities by way of loan, discount, or otherwise, loans on collateral security, negotiation of loans, either as an instrument of a permanent character or temporarily with a view to sale or repayment and reinvestment.

"It is apparent from this definition that either the average amount of loans and discounts placed through New Jersey offices (as compared with the amount everywhere) or the gross business done through New Jersey offices (as compared with the gross everywhere) would be a satisfactory measure of the employment of competing capital in this State.

"Thus, a national corporation which has a total of $5 million in loans outstanding and which has four offices in New Jersey with total outstandings of $500,000 might allocate 10 per cent of its total capital, surplus and undivided profits to New Jersey. This 10 per cent of the total which is allocated to New Jersey would in turn be allocated as among the four New Jersey offices according to the amount of loans outstanding of each of them.

"Outstandings might not be satisfactory, however, to allocate capital of an investment company which may deal partly in stock equities and partly in Governments and municipals. For this type of company, gross business might be a more practical measure of allocation. It could be defined as the sum of:

1) Fees, commissions or other compensation for financial services rendered within this State.

2) Gross profits from trading in stocks, bonds or other securities managed within this State.

3) Interest and dividends received on loans, stocks, bonds and other securities managed within this State.

4) Interest charged to customers, at places of business maintained within this State, for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying such accounts.

5) Any other gross income resulting from the operation of financial business within this State.

divided by the aggregate amount of such items of the taxpayer everywhere.

"The advantage of a single formula, reasonably related to turnover of capital in New Jersey, as compared with the possible use of outstandings, seems to justify the somewhat more complicated gross business basis. The *Commission* accordingly recommends:

V. THAT CAPITAL EMPLOYED BE ALLOCATED IN PROPORTION TO GROSS BUSINESS DONE IN NEW JERSEY, AS HEREIN DEFINED." (*First Report of the Commission of State Tax Policy* (1946), pp. 29-31.)

It cannot be contended, therefore, that the allocation formula predicated upon gross receipts is unreasonable and certainly, none of the appellant's arguments should serve to displace the judgment of the New Jersey State Legislature in determining to use such a formula. *Cf. Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U. S. 522, 79 S. Ct. 437, 3 L. Ed. 2d 480 (1959).

Appellant argues that the gross receipts formula is not reasonable because it is applied to net worth computed in part by assets which themselves do not directly produce revenue or receipts. Appellant refers specifically to its so-called "headquarter assets" which consist largely of the

very substantial sums of money which it keeps on hand, in banks, and in transit and which circulate throughout its entire enterprise and constitutes the funds which it loans to the general public. The distinction between cash which is used for the purposes of loans and outstanding loan or loan accounts which admittedly "produce" revenue is tenuous in a small loan finance business such as that of appellant wherein there is a rapid turnover of cash and liquidation of loans. Moreover, even if it be conceded that the so-called "headquarter assets" do not themselves produce revenue obviously they are vitally necessary for the production of revenue and receipts and hence are appropriately included in net worth to be allocated according to the business done by the appellant. *Cf. Bass, Ratcliff & Gretton* v. *State Tax Commission*, 266 U. S. 271 45 S. Ct. 82, 69 L. Ed. 282 (1924); *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 41 S. Ct. 45, 65 L. Ed. 165 (1920); *Ford Motor Co.* v. *Beauchamp, supra.*

Appellant's argument in this respect confuses the tax in question with an *ad valorem* tax upon property. The New Jersey Supreme Court has explicitly rejected this characterization of the tax. It stated:

> "* * * Household argues that these ['household'] assets have their *situs* in Chicago and that unless they are excluded from net worth, New Jersey would tax extraterritorial values in violation of the due process provision of the *Federal Constitution.*
>
> "The statute does not tax assets beyond the State. Rather, it imposes an excise tax upon the doing of financial business in New Jersey. N.J.S.A. 54:10B-3. That the tax is assessed upon a portion of net worth does not mean that it is an *ad valorem* assessment upon any of the underlying properties. *Werner Machine Co.* v. *Director of Division of Taxation*, 17 N. J. 121

(1954), affirmed 350 U. S. 492, 76 S. Ct. 534, 100 L. Ed. 634 (1956). Net worth simply sums up the relationship between assets and liabilities and thus expresses the experience of an enterprise. It is not 'property' and of course is not an 'asset' in a balance sheet. It is merely a concept, without tangible *situs* in any specific asset.

"In a sense, the excise tax may gather the hue of a property tax, but if so viewed, it is the franchise to local business that is being valued rather than any specific piece of property devoted to it. In thus appraising the worth of a franchise, it is fitting to refer to 'net worth,' for the franchise ultimately contributes to that balance-sheet result. And in dealing with a multi-state business, unitary in nature, it is reasonable to assume the franchise to do business in this State contributes to the net worth in the proportion that the business done here bears to the total business of the taxpayer" (Court's emphasis) (36 N. J. at p. 358, 177 A. 2d at p. 741)

It is respectfully submitted, therefore, that the utilization of an allocation formula based upon gross receipts for purposes of apportioning the net worth of a financial business such as that of appellant, for franchise tax purposes, is entirely reasonable and that the inclusion in appellant's net worth of its so-called "headquarter assets" for allocation purposes was reasonable and consistent with the due process requirements of the Fourteenth Amendment.

POINT II

The statutory allocation fraction, which included among the gross receipts of appellant the dividends, interest and fees which it received from its subsidiary corporations but excluded the direct receipts earned by the subsidiary corporations, did not result in a "palpably disproportionate" apportionment of appellant's net worth to New Jersey for franchise purposes.

Plaintiff complains that the computation of the allocation fraction under the statute by the State Director of the Division of Taxation was unreasonable because it "penalizes the use of corporate subsidiaries". Specifically, plaintiff complains that it is improper to include in the denominator of the fraction (consisting of appellant's total gross receipts earned everywhere) the dividends, interest and supervision fees which appellant's subsidiary corporations paid to it during the tax years in question. This error, appellant contends, was compounded by the exclusion from these *gross receipts of the receipts earned directly* by the subsidiary corporations on the small loan business conducted by them.

At the hearing before the State Division of Tax Appeals, the appellant offered several alternative methods for apportioning its net worth. It demonstrated the results of apportionment on various bases such as receipts, assets, consolidated assets, consolidated receipts and consolidated net operating income (Resp. App. B, 8a-9a; App. C, 10a). It also adduced evidence as to apportionment based upon "consolidated loan accounts" (Appl. App. B, 7a).

Appellant did not establish by these comparative methods of apportioning net worth that the apportionment formula of the New Jersey statute, based upon "unconsoli-

dated" gross receipts was unreasonable. In fact, the testimony of its own expert demonstrates that the New Jersey apportionment formula, while not perfect, was not unreasonable.*

Appellant, on this appeal, appears to eschew any particular method of apportionment. Thus it states by way of a footnote to its schedule appearing on page 7 of its Jurisdictional Statement that it "does not advocate a consolidated gross receipts allocation formula or an allocation formula based on any other specific theory". Yet the schedule on that page purports to make a comparison of an apportionment based upon "consolidated gross receipts" with the statutory apportionment based upon "unconsolidated" gross receipts. As will be argued under Point III, *infra*, there does not appear to be a sufficiently substantial difference between the apportionment formula utilized by appellant by way of "illustration" and the statutory formula utilized by the State Director of Taxation which would justify a reversal of the decision of the court below.

Even though appellant states that it does not espouse an allocation formula based on "consolidated" gross receipts, it nevertheless argues that the statutory apportionment formula was erroneous because it did not include in the denominator thereof the gross receipts of the subsidiary corporations. In other words, appellant does in

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* "Q. What, then, is your opinion as to the appropriateness and reasonable accuracy from an accountancy standpoint of the 6 apportionment methods? A. Well, I think each method would produce reasonable accurate results. None of them are perfect. Each has some defects, but they all bear some relationship to the contribution of net worth of each individual segment of business of the corporation. * * *" (Resp. App. I; 7a) Included in the "6 apportionment methods" is the statutory apportionment based upon the "unconsolidated" receipts of appellant.

fact argue the apportionment formula was erroneous because the denominator did not consist of "consolidated" gross receipts of appellant and its subsidiaries.

The inclusion in total net worth of the appellant's capital stock in the subsidiary corporations, subject to apportionment, does not require the inclusion in the allocation factor of the gross receipts earned by the subsidiary corporations. It was held, for example, in *Commonwealth v. Koppers Company, infra*, that the *omission* from the tax base consisting of taxable net income of certain types of receipts did not require that these receipts be similarly omitted from an allocation fraction based upon gross receipts (397 Pa. 523, 529, 156 A. 2d 328, 332 (Sup. Ct. 1959)). A similar determination was made in *Commonwealth v. Ford Motor Co.*, 350 Pa. 236, 38 A. 2d 329 (Sup. Ct. 1944), *appeal dismissed for lack of substantial federal question*, 324 U. S. 827, 65 S. Ct. 857, 89 L. Ed. 1394 (1945).

More significantly, close scrutiny of appellant's position discloses that it did not below nor does it before this Court seek to establish a tax base upon a truly "consolidated" position. The New Jersey Supreme Court quite properly discerned this:

> "What Household sought was a hybrid result under which its corporate lines would be respected as to New Jersey operations and disregarded elsewhere. More specifically, Household wanted the right to file separate returns for the New Jersey subsidiaries while using a consolidated approach with respect to the others. It in fact did file separately for the New Jersey subsidiaries, and upon the redetermination insisted before the Director that their net worth be excluded from total net worth under N.J.S.A. 54:10B-6(a)(3), a proposition with which the Director agreed. So also Household excluded the gross receipts of New Jersey subsidiaries from the allocation fraction.

"After oral argument we sought clarification of Household's position in this respect. We were informed:

"'However, the statute (¶6) requires that Taxpayer's subsidiaries which are active in New Jersey be separately taxed on their own local franchises. The statute shows a clear legislative intent to draw a distinction between the local subs' own franchise to operate locally, which is separately taxable, and the Taxpayer's distinctive franchise to own those subs, which is taxable or not according to where it is held and exercised. Accepting the statutory distinction (as both parties do), the problem is simply to measure the portion of Taxpayer's net worth which represents this value and to determine its taxable situs.'

And further:

"'. . . . Moreover, if the disregard of corporate lines appears to be only a partial one (that is, the middle ground under which Taxpayer's New Jersey subs are fractioned off individually), this is solely because of the explicit requirements of ¶6, which requirements, incidentally, both parties accept and which therefore should be accepted by the Court as binding for the purposes of this appeal.'

"Quite obviously, if the gross receipts of the New Jersey subsidiaries were included in the numerator and denominator of the allocation fraction, the fraction would be enlarged. This is apparent from a simple example, let us say, of adding 5 to the numerator and denominator of the fraction 5/20 which would result in the fraction 10/25. If the fraction, augmented above and below the line by the gross receipts of the New

Jersey subsidiaries, were applied to the total net worth, the portion allocable to New Jersey would not necessarily be the same as the total of (1) the net worth of the New Jersey subsidiaries and (2) the portion of Household's remaining net worth allocated to New Jersey by a fraction having the New Jersey branch office receipts as the denominator. We do not know the tax-dollar consequences for the years in question of that dual approach, but it seems clear that, in espousing the split approach we have described (cf. *Household Finance Corp.* v. *State Tax Comm'n*, 217 Md. 327, 142 A. 2d 807 (Ct. App. 1958)), Household seeks an opportunity to control its total tax by the expedient of deciding which New Jersey offices to operate through subsidiaries and which to operate as branches.

"The statute permits Household to operate in New Jersey through subsidiaries with separate treatment of them. Household simply seeks to fashion still another choice, whereby it may 'consolidate' its out-of-State operations while maintaining the integrity of corporate lines with respect to the New Jersey segment of its total operations. The statute does not permit and surely due process does not require that incongruity." 36 N. J. pp. 363, 364, 177 A. 2d pp. 744, 745.

With respect to propriety of the inclusion in the denominator of the allocation fraction of the interest, supervision fees and dividends, it appears clearly that these receipts should be considered as the receipts of the appellant in the conduct of its general financial business in accordance with its own corporate structure.

In the year ending December 31, 1953, appellant had loaned its subsidiaries $96,628,926; in the year 1954, $108,600,062; in the year ending 1944, $146,495,915.11 and in the year ending 1956, $206,837,923.04. These loans or advances represented the bulk of the funds which the subsidiaries loaned to individual customers through their own branch offices in the course of carrying out their small loan finance business. In each of the foregoing years respectively appellant received $649,346.65, $2,862,821.37, $4,533,564.01 and $7,934,902.16 as interest on these loans. The appellant obviously considered that the gross receipts which it received as interest on personal loans made directly by it through its own branches constituted "interest and dividends received on loans," within the meaning of N.J.S.A. 54:10B-8(c). In the eyes of the statute, the interest received by appellant from its loans or advances to subsidiaries stand in no different posture from interest received on loans to individual borrowers. The rates might be different. The classes of borrowers differ and, perhaps there is some underlying, undisclosed motivation in making loans or advances to subsidiaries which differs from the policy applicable in making loans directly to the public. Gross receipts from both types of loans, however, constitute interest or other compensation for financial services within the meaning of the statute.

It is equally clear that appellant's receipts, denominated "supervision fees" paid by the subsidiary corporation for the various services furnished by appellant are "fee, commissions, or other compensation for financial services within the meaning of N.J.S.A. 54:10B-8(a). At the very least, they fall within the ambit of "any other gross income resulting in the operation of financial business within this state." (N.J.S.A. 54:10B-8(e)).

Nor, can it be contended satisfactorily that the dividends paid to the appellant by its subsidiary corporations were

not properly included in the denominator of the allocation fraction by the Director. Assuredly, such dividends are "* * * dividends received on * * * stocks" within the meaning of N.J.S.A. 54:10B-8(c). *Gulf Oil Corporation* v. *Morrison*, 120 Vt. 324, 141 A. 2d 671 (Sup. Ct. 1958); *Commonwealth* v. *Koppers Company*, 397 Pa. 523, 156 A. 2d 328 (Sup. Ct. 1959), *appeal dismissed for want of a substantial federal question, sub nom. Koppers Co., Inc.* v. *State of Pennsylvania*, 364 U. S. 286, 81 S. Ct. 43, 5 L. Ed. 2d 38 (1960).

It is respectfully urged, therefore, that the Director's computation of the gross receipts allocation factor, in accordance with the formula prescribed by the statute, was entirely reasonable and did not contravene appellant's rights under the due process clause of the Fourteenth Amendment.

POINT III

There exists no substantial federal question on this appeal since it has not been demonstrated that the apportionment of Appellant's net worth to New Jersey for franchise tax purposes was "palpably disproportionate" to the value of its local franchise.

Appellant has not established by "clear and cogent evidence" that the New Jersey apportionment formula, as applied to it, was "palpably disproportionate" and resulted in the taxation of "extraterritorial values". *Railway Express Agency* v. *Virginia*, 358 U. S. 434, 443, 444, 79 S. Ct. 411, 417, 418, 3 L. Ed. 2d 450, 457 (1959).

As mentioned under Point II, *supra*, appellant at the hearing below suggested several alternative bases of apportionment, such as assets, loan account, net operating income and payrolls. Taking the year 1955, by way of an

example, the average of these alternative methods suggested by appellant was 3.59%. The percentage under the New Jersey statute was 4.72% which is slightly more than 1% of the average of appellant's suggested methods (Resp. App. C, 10a). Moreover, if a comparison be made between the allocation factor based upon "unconsolidated" gross receipts as computed by the State Director of the Division of Taxation and an allocation fraction based upon the "actual consolidated gross receipts" for 1955, it is clear that the difference between the two is not sufficient to warrant the invalidation of the New Jersey formula. Thus, for the year 1955, the New Jersey percentage based upon unconsolidated gross receipts was 4.72%. The percentage based upon consolidated gross receipts was 3.82%, a difference of less than 1%. In 1957 the New Jersey percentage based upon unconsolidated gross receipts was 3.61% and the percentage based upon consolidated gross receipts was 2.95%, a difference of only approximately ½ of 1%. The average New Jersey percentage for all of the tax years involved based upon unconsolidated gross receipts was 4.58%. The average percentage for all the years involved based upon consolidated gross receipts was 3.54%, a difference of only 1.04%.

Moreover, while the average of all of the methods of allocation suggested by appellant for the year 1955 is 3.59% as compared to the New Jersey percentage of 4.72%, if the New Jersey percentage based upon unconsolidated gross receipts were averaged with appellant's other percentages the total average would be 4.15%. The difference between 4.15% and 4.72% is .57%, ½ of 1%, which is certainly *de minimis*.

Additionally, it may be observed that the other allocation fractions suggested by the appellant were based upon "consolidated" factors. There is, however, no necessary

justification or requirement that the allocation fractions be based upon "consolidated" factors. If a comparison be made between the statutory allocation fraction based upon gross receipts (not consolidated) and the allocation fractions based upon the other factors suggested by the appellant on an *unconsolidated* rather than a consolidated basis, it appears even more forcibly that the statutory allocation fraction applied by the Director was most reasonable. Such a comparison illustrates graphically that the statutory allocation based upon unconsolidated gross receipts was *less* than each of the allocation fractions suggested by the appellant based upon *unconsolidated* assets, loan accounts and net operating income (Resp. App. D, 11a).

The foregoing confirms the essential soundness of the principles enunciated by this Court in determining the reasonableness of state statutory apportionment formulae devised for purposes of local taxation of multi-state taxpayers. This Court has recognized consistently that mathematical precision and exactness in apportionment is impossible of achievement and is not required. *National, C & St. L. Ry.* v. *Browning*, 310 U. S. 362, 365, 60 S. Ct. 968, 970, 84 L. Ed. 1254, 1256 (1940). All that is required is apportionment upon some reasonable basis. *International Harvester Co.* v. *Evatt*, 329 U. S. 416, 67 S. Ct. 444, 91 L. Ed. 390 (1947). The New Jersey statutory allocation fraction based upon gross receipts which was applied to apportion appellant's net worth comes well within the ambit of these standards.

The principal authorities upon which appellant relies do not sustain its contention that the Financial Business Tax Law (1946) as applied to it apportions to New Jersey an unreasonable or palpably disproportionate share of appellant's total net worth. *Hans Rees' Sons* v. *State of*

North Carolina, 283 U. S. 123, 51 S. Ct. 385, 75 L. Ed. 879 (1913) involved a direct tax upon net income imposed by the state of North Carolina upon a foreign manufacturing corporation. By a statutory allocation, North Carolina attributed between 66 and 85% of the taxpayer's net income for the years in question to that state. In the view of the Court, however, the taxpayer had proved that the percentage of its income attributable to North Carolina for the years in question did not in any event exceed 21.7%. On the basis of these facts, the Court held the state allocation was arbitrary and unreasonable and, therefore, unconstitutional.

Hans Rees' Sons is inapplicable because there was involved, not a privilege tax, but a direct tax upon net income. Just as a state may not impose a direct property tax upon securities issued by the Federal Government, *Werner Mach. Co.* v. *Div. of Taxation*, 350 U. S. 492, 76 S. Ct. 534, 100 L. Ed. 634 (1956), so it may not impose a direct tax upon net income which was not created or earned within the taxing jurisdiction, *Bass, Ratcliff & Gretton* v. *State Tax Commission, supra*; *Underwood Typewriter Co.* v. *Chamberlain, supra*; *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U. S. 450, 79 S. Ct. 357, 3 L. Ed. 2d 421 (1959); *Williams* v. *Stockham Valves & Fittings Inc.*, 358 U. S. 450, 79 S. Ct. 357, 3 L. Ed. 2d 421 (1959). Since North Carolina sought in the *Hans Rees' Sons* case to tax more than three times the income which the Court found was, under any view of the facts, attributable to North Carolina, the tax was unconstitutional.

In the instant suit, however, the New Jersey statute imposes a franchise or privilege tax. Petitioner has not shown that the measure of the value of that privilege as fixed by the New Jersey statute for tax purposes is beyond any reasonable proportion to the benefit conferred. Fur-

thermore, the discrepancy between the statutory measure of the tax imposed upon appellant and the value of its total net worth which it concedes could be attributable to New Jersey is insubstantial.

The case of *Wallace* v. *Hines*, 253 U. S. 66, 40 S. Ct. 435, 64 L. Ed. 782 (1920) is even less helpful to appellant. *Wallace* v. *Hines* was an excise tax upon an interstate railroad measured by the taxpayer's property within North Dakota. The value of the North Dakota property was defined to bear the same proportion to the total value of the railroad property wherever located as the length of its trackage in North Dakota bore to its trackage everywhere. The Supreme Court held that, since North Dakota was a plains state, almost entirely agricultural, without great railroad depots or terminals, while the other states traversed by its tracks were mountainous and contained the railroad's major installations, there was no factual basis for assuming that the value of the taxpayer's property was distributed evenly according to its main track mileage. The court also pointed out that a substantial part of the value of the railroad's assets consisted of land grants and mortgages on land in other states. The Court held that it would not be permissible to allocate value according to main trackage attributing a portion of such mortgages and land grants to the North Dakota property, unless it could be shown in some plain and fairly intelligible way that it adds to the value of the road and the right exercised in the State.

In the case *sub judice*, the record is replete with facts demonstrating that appellant's "headquarters" assets and its investment in subsidiary corporations do contribute in some real measure to the value of its New Jersey business as well as its business conducted throughout the nation. *Wallace* v. *Hines* certainly stands as no bar to allocating, by a gross receipts formula, a portion of these assets and

investments to the New Jersey taxable net worth. In *Bass, Ratcliff & Gretton v. State Tax Commission, supra*, the United States Supreme Court stated, "In *Wallace* v. *Hines* • • • it was recognized that a State, in imposing an excise tax upon foreign corporations in respect to doing business within the State, may look to the property of such corporations beyond its borders to 'get the true value of the things within it, when they are part of an organic system of wide extent,' giving the local property a value above that which it would otherwise possess, and may therefore take into account property situated elsewhere when it 'can be seen in some plain or fairly intelligible way that it adds to the value of the [property] and the rights exercised in the State'" (266 U. S. at p. 282; 45 S. Ct. p. 84; 69 L. Ed. at p. 287). Moreover, *Wallace* v. *Hines* is fully consistent with subsequent cases holding that when a taxpayer, engaged in a multiform business, owns property unconnected with its business or activities within the taxing state, the value of such property must be excluded in computing the measure of the tax. Where, however, such property adds to the value of the privilege enjoyed by a unitary and integrated enterprise within the State, it may be included in part in the measurement of the tax. *Ford Motor Co.* v. *Beauchamp, supra.* Compare *Commonwealth* v. *Columbia Gas & Electric Corp.*, 336 Pa. 209, 8 A. 2d 404 (Sup. Ct. 1939) with *Commonwealth* v. *Ford Motor Co.*, 350 Pa. 236, 38 A. 2d 329, *supra.*

CONCLUSION

The New Jersey Supreme Court in a careful and well-reasoned opinion determined that it was entirely reasonable and proper for the State Legislature to provide for the apportionment of the net worth of a multistate taxpayer, conducting a local financial business, by a fraction based upon gross receipts for purposes of valuing the

franchise privilege accorded to such a taxpayer by the State of New Jersey. The Supreme Court of New Jersey properly determined that the computation of the apportionment fraction based upon gross receipts did not result in a "palpably disproportionate" attribution of the appellant's net worth to New Jersey for franchise tax purposes. Moreover, it did not appear by any cogent and persuasive evidence that the proportion of appellant's net worth actually allocated to New Jersey for tax purposes under the statutory formula was palpably or egregiously disproportionate to that proportion of net worth which might be apportioned to New Jersey under other conceivable methods of allocation. The foregoing demonstrates conclusively that the appellant has raised no substantial Federal question which would warrant the further attention of this Court and, therefore, it is respectfully urged that the instant appeal be dismissed.

Respectfully submitted,

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Attorney General of New Jersey
Attorney for Respondent, Director of the Division of Taxation.

ALAN B. HANDLER,
Deputy Attorney General,
Of Counsel and on the Brief.

Dated: August 7, 1962

APPENDIX A

Excerpts from Appellant's Petition of Appeal

(Filed—October 29, 1957)

* * *

4. Without New Jersey, but not within this State, Taxpayer also has engaged and engages in a holding-company business, consisting of beneficially owning, holding, managing and controlling all, or substantially all, of the capital stock of certain subsidiary corporations. At all times relevant hereto, said subsidiaries were engaged in the business of lending money in Canada and in numerous states of the United States of America, including some subsidiaries operating in New Jersey.

5. Taxpayer's said holding-company business did not and does not constitute a "financial business" as defined in Section 2(b) of the Statute; and was not and is not within the territorial limits of New Jersey. Therefore, so much of Taxpayer's total net worth as was and is represented by its said non-financial or holding-company business, was not and is not subject to the tax in New Jersey. Although such of Taxpayer's subsidiaries as do a financial business in New Jersey, are themselves separately taxable under Section 6 of the Statute, Taxpayer's holding-company business in respect to them is neither a financial business nor located within the territorial limits of New Jersey.

6. As an incident to Taxpayer's said holding-company business, Taxpayer, from its headquarters office in Chicago and from 3 regional headquarters outside New Jersey, (at

all times relevant hereto) supervised its subsidiaries' operations; provided accounting services to them; and, on occasion, advanced money to them for their corporate purposes. In consideration of such services and advances, Taxpayer (at all times relevant hereto) received from the respective subsidiaries, supervision fees and interest on such advances.

* * *

12. By said adjustments and redeterminations, the Bureau recomputed Taxpayer's New Jersey Taxable Net Worth for each of the years in question, as follows:

(a) The Bureau first increased Taxpayer's total net worth (as adjusted by Taxpayer in said returns), by adding thereto certain amounts representing dividends payable to Taxpayer's stockholders holding more than 10% of Taxpayer's total outstanding stock, as required by Section 2(c)(1)(5) of the Statute (which dividends had inadvertently been omitted by Taxpayer). The Bureau then decreased such adjusted net worth by increasing Taxpayer's bad-debt reserve so as to conform to the Bureau's revised policy in respect thereto. *These two adjustments are not in controversy.*

(b) To Taxpayer's total net worth as so adjusted the Bureau then added an amount equal to the amount by which the book value of Taxpayer's stock in its subsidiaries *per the subsidiaries' books*, exceeded the book value or cost thereof *per the Taxpayer's books*, (with a minor allowance with respect to one subsidiary in which Taxpayer owned less than all of the capital stock). As the result, the Bureau arrived at a figure which in fact represents *consolidated* net worth. This is protested.

(c) As a further adjustment, the Bureau then sought to exclude from such *consolidated* net worth, as non-taxable, that part thereof which was represented by Taxpayer's non-financial or holding-company business. However, the Bureau did so in an erroneous manner. The Bureau disallowed Taxpayer's asserted non-financial-business deduction from total net worth [which is described in paragraph 8(b) above]; and, instead thereof, excluded from such *consolidated* net worth that proportion thereof which Taxpayer's *unconsolidated receipts* (interest, dividends and supervision fees) from said *non-financial or holding-company business*, bore to Taxpayer's total gross income from all of its businesses wherever located. In other words, Taxpayer in its returns had excluded its non-financial business by a net-worth deduction based on an apportionment of assets [see paragraph 8(b) above]; whereas the Bureau has substituted an apportionment technique and an accounting principle which are inappropriate to the nature of Taxpayer's various businesses. Furthermore, in doing so, the Bureau mixed *consolidated* factors with *unconsolidated* factors having no reasonable relationship to one another. This resulted in an *erroneous and inflated* amount as Financial-Business Net Worth. This the Taxpayer protests.

(d) The Bureau then excluded from total net worth [as erroneously computed and inflated as stated in subparagraphs (b) and (c) of this paragraph], that proportion of such total net worth which Taxpayer's gross income from its financial business *without New Jersey*, bore to the sum of (i) its non-financial receipts (wrongly measured as aforesaid) and (ii) its gross income from its financial business wherever located,—

Appendix A

thus leaving as New Jersey Taxable Net Worth that proportion of such total net worth which Taxpayer's gross income from its financial business *within New Jersey*, bore to the sum of (i) its non-financial receipts wrongly measured), and (ii) its gross income from its financial business wherever located. The Taxpayer protests the Bureau's application of erroneous fractions to said erroneous and inflated base.

* * *

16. Pursuant to Taxpayer's request, a hearing was had on August 28, 1957, before the Supervisor of the Bureau, acting for the Director. At said hearing all of Taxpayer's protests and objections were disallowed; except that Taxpayer was sustained with respect to its right under Section 6 of the Statute to exclude, from its New Jersey Taxable Net Worth, the value of its subsidiaries operating in New Jersey which are themselves separately taxable under the Statute.

* * *

19. At all times relevant hereto, said Headquarters Property, although used in the management of Taxpayer's entire business, was located entirely outside New Jersey. Accordingly, that proportion of Taxpayer's entire net worth which said Headquarters Property bore to Taxpayer's total assets, was and is outside the territorial limits of, and not taxable by, New Jersey. Therefore, on any revision of Taxpayer's determination of New Jersey Taxable Net Worth, or of the Bureau's redetermination thereof, the aforesaid proportion of adjusted net worth should be excluded from Taxpayer's adjusted net worth, in order to exclude from taxation by New Jersey, the portion thereof

represented by such non-income-producing Headquarters Property outside of New Jersey.

22. Therefore, Taxpayer petitions for a judgment with respect to Taxpayer's tax liability for the tax-payment years 1954, 1955, 1956 and 1957 under the New Jersey Financial Business Tax Law (1946), [N.J.S.A. 54:10B-1 *et seq.*], as follows: * * *

D. Adjudging and declaring that, with respect to this Taxpayer and the 4 tax-payment years in question, the Statute, and the adjustments and redeterminations with respect to Taxpayer's tax liability thereunder, which the Bureau and the Director made purportedly under and in accordance with the Statute, are unlawful and unconstitutional, * * *

* * *

APPENDIX B

Excerpts from Record Below

(Filed—January 25, 1960)

Transcript of testimony before the Division of Tax Appeals, Commissioner Ellis M. Kopp presiding, in Room 441, State House Annex, Trenton, New Jersey, on Tuesday, January 12, 1960, at 10:30 A.M.

Appearances:

PITNEY, HARDIN & WARD, by ROGER C. WARD, Esquire, for the Petitioner.

DAVID D. FURMAN, Attorney General, by MURRY BROCHIN, Esquire, Deputy Attorney General.

• • •

"Mr. Ward:

• • •

"[W]e will concede that our business is unitary in the sense of the cases which discuss apportionment in the cases of unitary or non-unitary businesses. • • •

"We concede each of the components of our net worth are components of the net worth and are part of the unitary business in the sense of those cases." (P85a-21 to 33)*

• • •

"Mr. Ward: • • • We concede now it was proper, or at least tolerable to consolidate value for subs' stock investment."

• • •

* These and similar references are to pages in the Appendix of Appellant filed with the New Jersey Supreme Court.

Appendix B

"Mr. Ward: * * * The subsidiaries could be included in the total net worth before apportionment. I would concede that." (P89a-15 to 33)

* * *

"Q. [Question by Mr. Ward to R. Bradner Mead, for petitioner on direct examination] * * *. Is it possible to relate the New Jersey Household Finance average loan account shown in Item No. 2 for each of the four years to the total consolidated average loan account shown in Item No. 3 for each of the four years? A. Yes.

"Q. Have you done that computation? A. Yes."

* * *

"Q. For 1954 tax year, please. A. 4.03%.

"Q. '55? A. 3.75%.

"Q. '56? A. 3.31%.

"Q. '57? A. 2.91%." (P117a-32 to P118a-14)

* * *

"Q. What, then, is your opinion as to the appropriateness and reasonable accuracy from an accountancy standpoint of the six apportionment methods? A. Well, I think each method would produce reasonably accurate results. None of them are perfect. Each has some defects, but they all bear some relationship to the contribution to net worth of each individual segment of the business of the corporation. * * *" (P119a-29 to 36)

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Exhibit P-1 (Annex 12 to Statement of Facts)

Adjusted Net Worth Apportioned on Various Bases

(Opposite) ☛

ANNEX 12

ADJUSTED NET WORTH APPORTIONED ON VARIOUS BASES

Tax year	Class of asset or business	(a) Receipts of taxpayer (preceding year) (1) % of total, Annex 7, column 10	(a) (2) Allocable portion of adj. net worth	(b) Assets of taxpayer (12/31 preceding year) (3) % of total, Annex 7, column 5	(b) (4) Allocable portion of adj. net worth	(c) Consolidated assets (12/31 preceding year) (5) % of total, Annex 9, column 2	(c) (6) Allocable portion of adj. net worth
1954	SUBS. (U.S. & CAN. CONSOL'D)	4.47	$ 5,575,513	30.28	$ 37,768,793	32.01	$ 39,926,654
	HFC HEADQUARTERS	0.00	-	6.28	7,833,158	6.12	7,633,587
	HFC BRANCHES OUTSIDE N. J.	89.91	112,147,996	59.76	74,539,733	58.28	72,693,702
	HFC BRANCHES IN N. J.	5.62	7,008,307	3.68	4,590,132	3.59	4,477,873
	TOTAL (Annex 8, line 8)	100.	$124,731,816	100.	$124,731,816	100.	$124,731,816
1955	SUBS (U.S. & CAN. CONSOL'D)	15.94	$ 21,328,297	32.30	$ 43,218,570	34.47	$ 46,122,109
	HFC U. S. HEADQUARTERS	0.00	-	5.35	7,158,494	5.18	6,931,028
	HFC BRANCHES OUTSIDE N. J.	79.34	106,158,322	58.90	78,810,333	57.01	76,281,445
	HFC BRANCHES IN N. J.	4.72	6,317,003	3.45	4,616,225	3.34	4,469,040
	TOTAL	100.	$133,803,622	100.	$133,803,622	100.	$133,803,622
1956	SUBS (U.S. & CAN. CONSOL'D)	17.48	$ 25,707,529	36.75	$ 54,047,580	38.61	$ 56,783,049
	HFC U. S. HEADQUARTERS	.02	29,414	4.65	6,838,673	4.52	6,647,485
	HFC BRANCHES OUTSIDE N. J.	78.12	114,885,153	55.56	81,711,116	53.93	79,313,904
	HFC BRANCHES IN N. J.	4.38	6,446,148	3.04	4,470,875	2.94	4,323,806
	TOTAL	100.	$147,068,244	100.	$147,068,244	100.	$147,068,244
1957	SUBS (U.S. & CAN. CONSOL'D)	28.17	$ 46,286,845	40.77	$ 66,990,226	42.12	$ 69,208,445
	HFC U. S. HEADQUARTERS	0.01	16,431	4.28	7,032,577	4.17	6,851,833
	HFC BRANCHES OUTSIDE N. J.	68.20	112,066,744	52.25	85,853,306	51.06	83,897,987
	HFC BRANCHES IN N. J.	3.62	5,942,528	2.70	4,436,439	2.65	4,354,283
	TOTAL	100.	$164,312,548	100.	$164,312,548	100.	$164,312,548

(c) lidated assets preceding year)		(d) Consolidated receipts (preceding year)		(e) Consol'd net op. income (preceding year)	
(6) Allocable portion of adj. net worth	(7) % of total, Annex 9, column 4	(8) Allocable portion of adj. net worth	(9) % of total, Annex 9, column 6	(10) Allocable portion of net worth	
$ 39,926,654	31.28	$ 39,061,112	37.77	$ 47,111,207	
7,633,587	0.00	-	-	-	
72,693,702	64.67	80,664,065	58.12	72,494,131	
4,477,873	4.05	5,051,639	4.11	5,126,478	
$124,731,816	100.	$124,731,816	100.	$124,731,816	
$ 46,122,109	31.92	$ 42,710,116	38.27	$ 51,206,646	
6,931,028	0.00	-	-	-	
76,281,445	64.26	85,982,208	57.73	77,244,831	
4,469,040	3.82	5,111,298	4.00	5,352,145	
$133,803,622	100.	$133,803,622	100.	$133,803,622	
$ 56,783,049	36.26	$ 53,326,945	42.58	$ 62,621,558	
6,647,485	0.02	29,414	-	-	
79,313,904	60.35	88,755,685	54.05	79,490,386	
4,323,806	3.37	4,956,200	3.37	4,956,200	
$147,068,244	100.	$147,068,244	100.	$147,068,244	
$ 69,208,445	41.29	$ 67,844,651	45.52	$ 74,795,072	
6,851,833	0.01	16,431	-	-	
83,897,987	55.75	91,604,246	51.58	84,752,412	
4,354,283	2.95	4,847,220	2.90	4,765,064	
$164,312,548	100.	$164,312,548	100.	$164,312,548	

APPENDIX C

Excerpts from Appellant's Main Brief Below†

* * *

Method of Allocation*	New Jersey Net Worth Dollars	New Jersey Net Worth Percent of Total Net Worth
1. Unconsol. Gross Receipts	$6,317,003	4.72%
2. Taxpayer's Assets	4,616,225	3.45
3. Consol. Assets	4,469,04	3.34
4. Consol. Receipts	5,111,298	3.82
5. Consol. Net Op. Income	5,352,145	4.00
6. Consol. Payroll	4,281,716	3.20
7. Consol. Loan Account	4,017,636	3.75
8. Average of 2 Through 7	4,808,010	3.59

*Line 1 is the Director's method. The derivation of the percentages of the New Jersey portion of taxpayer's net worth shown in Lines 2-5 is summarized above at p. 11, based upon four different classifications or modes of expressing taxpayer's total business enterprise. The percentages shown in Lines 6 and 7 were testified to by Mr. Mead; and that the actual arithmetic of applying the percentages to an adjusted total net worth of $133,803,622 does not appear in the record, but was done by counsel for purposes of this brief."

† The foregoing excerpt appears on page 29 of Appellant's Brief filed with the New Jersey Supreme Court. The table refers only to the year 1955.

APPENDIX D

Comparison of Allocation Fractions*

	1954	1955	1956	1957
(1) *Assets*				
New Jersey	14,138	13,893	14,075	14,989
Everywhere	267,743	272,211	292,792	328,824
Allocation fraction	5.2804%	5.1038%	4.8072%	4.5584%
(2) *Loan Account*				
New Jersey	13,525	13,774	13,456	14,310
Everywhere	223,028	242,787	252,228	283,968
Allocation fraction	6.0643%	5.6733%	5.3349%	5.0393%
(3) *Net Operating Income*				
New Jersey	1,776	1,809	1,593	1,756
Everywhere	26,883	27,746	27,124	33,075
Allocation fraction	6.6064%	6.4874%	5.8730%	5.3091%
Average of 1, 2 and 3:	5.9837%	5.7548%	5.3384%	4.9689%
Statutory allocation fraction based on Gross Receipts	5.6187%	4.7211%	4.3831%	3.6166%

* The figures are derived from the tables appearing in Appellant's Brief filed with the New Jersey Supreme Court on pages 11 and 29 and are derived from Annex 12. (See Resp. App. B, 8a-9a).

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961.

No. 237.

HOUSEHOLD FINANCE CORPORATION,

Appellant,

vs.

DIRECTOR OF THE DIVISION OF TAXATION, DEPARTMENT OF THE TREASURY OF THE STATE OF NEW JERSEY,

Respondent.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY.

APPELLANT'S BRIEF OPPOSING RESPONDENT'S MOTION TO DISMISS AND APPELLANT'S APPENDIX F.

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August 28, 1962.

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ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY.

APPELLANT'S BRIEF OPPOSING RESPONDENT'S MOTION TO DISMISS.

Introduction.

On the basis of the jurisdictional statement and respondent's brief, the primary question on this appeal is how to measure the "total business of the taxpayer" against which the taxpayer's business local to New Jersey is to be compared. A related question is whether the fact that an excise tax is involved entitles the State of New Jersey to tax extraterritorial values.

. . . . . .

The court below stated (Appellant's Appendix A, p. 6a):

> "* * * it is reasonable to assume the franchise to do business in this state contributes to the net worth in the proportion that the business done here bears to the total business of the taxpayer."

The statute provides (Respondent's Brief, p. 10) that this allocation shall be on the basis of

> "the taxpayer's gross receipts arising from its New Jersey business divided by its gross receipts arising from its business done everywhere."

The statute defines gross receipts in detail, but it does not specify the *business* from which the significant gross receipts flow. Also, it does not provide alternative methods of allocation for franchise values which are simply not measurable in terms of gross receipts. In this appeal the central question is how to select or define "the total business of the taxpayer" against which to compare the local business consistently with due process.

Upon the facts of this case, three different types of gross receipts problems are involved:

(1) Both in the numerator and in the denominator there are gross receipts from customers of appellant who do business with it in the offices which it owns directly.

(2) In the denominator there are dividends, interest, and supervision fees from appellant's Canadian subsidiaries and interest and supervision fees from its U. S. subsidiaries which are not comparable to receipts from customers of the parent and which the court below stated were less in each case than the gross receipts from the customers of these subsidiaries. When compared to the gross receipts from appellant's New Jersey customers which make up the numerator, these reduced gross receipts from appellant's out-of-state subsidiaries exert an arbi-

trarily reduced weight in the denominator of the gross receipts fraction. This increased the fraction and operated to subject extraterritorial values to the New Jersey franchise tax.

(3) In the total net worth to be allocated, there are out-of-state headquarters assets which directly produced virtually no gross receipts which could reflect their contribution to appellant's business (*a fortiori* the geographical distribution thereof) in the denominator of the gross receipts fraction. The gross aggregate value of these headquarters assets ranged from $21,000,000 to $24,000,000 for the four years under review and included both tangible and intangible property. The statute does not contain a property fraction and therefore makes no provision for dealing with the contribution to a business of assets used in and necessary to the business but from which no income is immediately derived and which, therefore, are not measurable and distributable in terms of gross receipts.

The foregoing disparities in respondent's method for measuring the various segments of appellant's out-of-state business and the portions of net worth represented by them distort the allocation formula so as to allocate substantial extraterritorial business or values to New Jersey.

Does the foregoing method of allocation for franchise tax purposes violate the 14th Amendment of the Federal Constitution in that it subjects extraterritorial business or values to the New Jersey franchise tax?

ARGUMENT.

I.

Can respondent subject extraterritorial business or values to its franchise tax?

A principal area of dispute concerns whether respondent can tax extraterritorial business or values under a franchise tax which it could not subject to a property tax. To support its position respondent quotes from the history of the legislation under which the tax is asserted (Respondent's Brief, pp. 14-17). That quotation includes the following:

> "The selection of a method of allocation depends upon the type of tax with which it will be used. If the proposed tax were deemed to be a property tax, the matter of allocation would be reduced to the simple proposition that the state may constitutionally tax only such property as may be found within the State. * * * Foreign corporations could be subject to a measure *including only that portion of their capital employed within the state.*
>
> "*Under an excise tax measured by capital, as proposed, there is considerably more freedom* to achieve a working equality of treatment as among the various classes of taxpayers, foreign and domestic corporations and unincorporated business. * * *". (Respondent's Brief, pp. 14-15, emphasis supplied)

The issue here presented arises under the due process and equal protection clauses of the 14th Amendment. As Professor Hartman put it in his article "State Taxation of Interstate Commerce: A Survey and Appraisal," 46 Va. Law Review 1051, 1059 (1960):

> "The restraining power of the due process clause, it might be said, keeps the taxing power at home. It prevents a State from fixing its tax talons on extraterritorial values."

This Court in *Central R. Co. of Pa.* v. *Pennsylvania*, U. S. , 8 L. Ed. 2d 720, 82 S. Ct. (decided June 25, 1962) recognized that assets should not be subject to property taxes in two jurisdictions and that the domiciliary state loses jurisdiction to tax property to the extent that it has acquired a property tax situs in a different jurisdiction. However, until proof of a non-domiciliary situs with tax potential has been provided, the domiciliary state retains the jurisdiction to tax.

Here the domiciliary state is Illinois. Included in appellant's net worth is a net value reflecting from $21,000,000 to $24,000,000 of headquarters assets, depending upon the year involved, plus the net value of appellant's investments in its subsidiaries. Under respondent's gross receipts formula the headquarters assets were given no weight and appellant's investments in its subsidiaries were given less weight (relative to appellant's assets in New Jersey) in terms of their respective contribution to appellant's business than the facts warrant. This has resulted in subjecting extraterritorial values to the New Jersey franchise tax. See *infra*, p. 10.

Respondent argues that *Ford Motor Co.* v. *Beauchamp*, decided in 1939 (Respondent's Brief, pp. 11-12; cf. Jurisdictional Statement, pp. 16-17), holds that all gross receipts allocation formulas, when used to measure excise taxes upon franchises, are valid. Respondent seems to argue further that in *Beauchamp* this Court foreclosed the taking of evidence concerning whether, in computing the weight to be given local assets in business use solely by gross

receipts apportionment, the formula results in a particular case in the taxation of extraterritorial franchises.

The crux of what this Court said in the *Beauchamp* case appears to lie in the following sentence quoted by respondent (Respondent's Brief, pp. 12-13):

> "The weight, in determining the value of the intrastate privilege, given the property beyond the state boundaries is but a recognition of the very real effect its existence has upon the value of the privilege granted within the taxing state."

This appears to be merely another way of stating what this Court said in the *franchise tax* case of *Wallace* v. *Hines*, 253 U. S. 66, 64 L. ed. 782, 40 S. Ct. 435 (1920):

> "The only reason for allowing a state to look beyond its own borders * * * is that it may get the true value of the things within it * * * ."

In the *Beauchamp* case this Court did not discuss what weight should be given to the property located outside the taxing state's boundaries in arriving at the franchise value to be taxed within the state. Specifically, *Beauchamp* was solely concerned with the resulting value taxed in comparison to the assets in Texas when valued alone, rather than with the method used to arrive at that taxable value.

Here the issue involves the validity of the method used to arrive at a value taxable in New Jersey. Does the dissimilarity in the character of the gross receipts used to measure business done within New Jersey as contrasted with the gross receipts used to measure "the total business" done everywhere violate due process? This lack of similarity has demonstrably subjected to the New Jersey tax a portion of total net worth value reasonably attributable to assets and business outside the state and therefore not reasonably attributable to New Jersey or subject to its

taxing powers. See *infra*, p. 10. Very recently this Court in effect reaffirmed the doctrine that due process precludes state taxes on extra-territorial values or transactions. It did so by invalidating a state tax measured by the premium cost of insurance contracts made outside the state where the only contact with the state was that the property insured was physically located there. *State Board of Taxation* v. *Todd Shipyards Corp.*, U. S. , 8 L. ed. 2d 620, S. Ct. (decided June 25, 1962). Appellant argues that an apportionment formula is not valid if it can be demonstrated that it results in the taxation of extraterritorial value whether the tax be a property tax as under *Central R. Co.* v. *Pennsylvania, supra*, or an excise tax, as here.

II.

There are defects inherent in a gross receipts formula as a measure of appellant's taxable net worth.

Respondent stated (Respondent's Brief, p. 22):

> "More significantly, close scrutiny of Appellant's position discloses that it did not below nor does it before this Court seek to establish a tax base upon a truly 'consolidated' position."

This statement is correct. Appellant does not advocate any form of gross receipts fraction as the last word in allocation. Even a consolidated gross receipts fraction fails to give any value to non-income-producing assets necessary to the conduct of a business.

No effective method to value appellant's non-income-producing headquarters assets under a gross receipts formula has been devised, with the result that their value has not been taken into account at all by respondent Respondent

seeks to project the use of headquarters assets into states where the branch offices operate, claiming that their only measurable contribution to value is to produce gross receipts indirectly in connection with local branch-office operations (*ibid*, pp. 3, 4, 7, 17-18, 30). Respondent excludes altogether (as necessarily also does the statute) appellant's non-revenue-producing business of owning, protecting and managing these assets where located. Consistently with this argument, the New Jersey Supreme Court observed that "the location of headquarters was of no moment. . . ." (Appellant's Appendix A, p. 6a).

Moreover, when respondent used gross receipts from appellant's customers in New Jersey to measure the net worth of appellant's New Jersey business, it also should use gross receipts from the subsidiaries' customers in the denominator if the values attributable to these two types of business are to be at all comparable. Appellant's subsidiaries are engaged in the same business as is appellant. They contribute to appellant's total business in relation to their gross receipts from customers to the same extent as do appellant's directly owned offices. It is significant that respondent does not seriously contend that appellant is merely in the business of managing and enjoying a portfolio of stocks and interest-bearing loans. On the contrary, respondent asserts that appellant conducts its small loan finance business and its Canadian operations "through subsidiary corporations" (Respondent's Brief, pp. 2, 3) and makes advances to its subsidiaries "for the purpose of providing these subsidiaries with funds for loans to the general public" (*ibid.*, p. 3). Nevertheless, only dividends, interest and supervision fees representing a fraction of the true receipts of that part of the business done by the subsidiaries are included by respondent in the "total business" against which "local business" is compared.

III.

Respondent misinterpreted appellant's expert witness.

The respondent's brief, at page 21, states:

> "In fact, the testimony of its own expert demonstrates that the New Jersey apportionment formula, while not perfect, was not unreasonable."

This statement was footnoted with the following:

> "'Q. What, then, is your opinion as to the appropriateness and reasonable accuracy from an accountancy standpoint of the 6 apportionment methods? A. Well, I think each method would produce reasonable accurate results. None of them are perfect. Each has some defects, but they all bear some relationship to the contribution of net worth of each individual segment of business of the corporation * * *' (Resp. App. B, 7a) Included in the '6 apportionment methods' is the statutory apportionment based upon the 'unconsolidated' receipts of appellant."

The first sentence quoted above and the concluding sentence in the foregoing footnote are inaccurate.

Appendix F hereto contains a more complete excerpt from the testimony of the witness quoted in respondent's brief. The witness testified concerning six formulas developed by him. Four of these appeared in appellant's trial exhibit known as Annex 12, which respondent reproduced as Appendix D of its brief in this Court. Two more were developed orally. Seemingly there is no dispute that this testimony related to six formulas which the witness was discussing when the above statement was made. Respondent's error is in stating that respondent's gross receipts

formula was one of these six. The testimony quoted above and in respondent's footnote does not deal with respondent's gross receipts formula except as the results of the six formulas he was discussing demonstrate the inadequacy of the State's formula. See especially Appendix F, pp. 52a-53a.

The expert witness's testimony concerning the State's gross receipts apportionment formula is that it is not valid for reasons set forth in the footnote at page 12 of appellant's Jurisdictional Statement.

IV.

The evidence shows that the State's formula resulted in the taxation of extraterritorial value.

In point II as well as point III of respondent's Brief, the Attorney General argues that appellant has not established the taxation of extraterritorial values by "clear and cogent" evidence and refers to Respondent's Appendices B, C, and D.

The figures in respondent's Appendix D are inaccurate as will be demonstrated later, *infra*, p. 12.

Appendix B includes a copy of Annex 12 to the Statement of Facts and is correct. Appendix C is taken from Appellant's main brief in the court below and is correct. The figures in these two exhibits together with the testimony of appellant's expert in respect to them (Appellant's Appendix D) constitute a broad summary of appellant's evidence of the taxation of extraterritorial value. Appellant contends that the evidence so summarized does constitute "clear and cogent" evidence of the taxation of extraterritorial values.

Respondent's Appendix C shows that, computed by the average of six different realistic methods (all supported by uncontradicted expert testimony) only 3.59% of total net worth value would be attributable to New Jersey for the tax year 1955, e.g.; but that the State's formula actually increased New Jersey's tax base by 31.38%, or 4.72% of total net worth value.

Out of a regard for brevity appellant did not include in the Appendices to its Jurisdictional Statement any reference to the above six formulas. However, taken with the testimony of appellant's expert witness (Appellant's Appendix F), they demonstrate that the contrast between the results of six realistic methods of allocation on the one hand and the results of respondent's method of allocation on the other hand clearly establishes that under respondent's method extraterritorial values are being subjected to the New Jersey tax.

That percentage increase represents for 1955 a realistic estimate of the amount of total net worth attributed to New Jersey by the State's formula but which actually was outside its territorial jurisdiction and subject to the taxing powers of other states.

An apportionment formula is not reasonable which contains the defects described by appellant's witness as quoted on page 12 of our Jurisdictional Statement, and which by reason of those defects overstates the tax base by one-third.

The data in Annex 12 attached to the Motion to Dismiss shows that for the other years in question the State's formula is similarly out of line with reality and similarly taxes extraterritorial values.

V.

Respondent's Appendix D is misleading and inaccurate.

The figures in respondent's Appendix D were not compiled by appellant. The footnote to the Appendix indicates that the figures are "derived from" appellant's figures in Annex 12 and its brief filed below.

In "deriving" the figures in the "everywhere" lines on that Appendix the respondent has subtracted from the consolidated figures appearing in the record below the entire amounts applicable to subsidiaries. Seemingly he did this to produce the figures in the "everywhere" lines which he calls (page 8) "unconsolidated assets, loan accounts and net operating income".

But after deducting from consolidated figures the items relating to the subsidiaries respondent should have *added back the intercompany items which had been eliminated in computing the consolidated figures.* The "everywhere" line, for example, under "assets" does not include *any* value for the investment in subsidiaries either consolidated or unconsolidated. The total assets of appellant as adjusted by the respondent himself in his redetermination for 1954, e.g., were $384,029,000 instead of only $267,743,000 as he now argues to this Court in his Appendix D.

Appellant's evidence establishes by "clear and cogent evidence" the taxation of extraterritorial values. Such evidence deserves to be discussed at greater length than is appropriate here.

VI.

The injury is not *de minimis*.

Respondent argues that the differences between the results under various formulas discussed in the record and the results under the State's formula were *de minimis*. (Respondent's Brief, pp. 27, 30.) For instance, the statement appears at page 27:

> "The average New Jersey percentage for all of the tax years involved based upon unconsolidated gross receipts was 4.58%. The average percentage for all the years involved based upon consolidated gross receipts was 3.54%, a difference of only 1.04%."

This is mathematical sleight of hand. 4.58% is 29.27% greater than 3.54%. Such a difference is not *de minimis*.

VII.

Public benefit will result from a decision of this appeal by this Court.

There is a public need to have this area of the law reviewed. Clarificaton of state power to tax multi-state businesses has long been needed. Uncertainty in these areas has been so vexatious that: "This Court alone has handed down some three-hundred full-dress opinions * * *" *Northwestern-States Portland Cement Co.* v. *Minnesota*, 358 U. S. 450, 457, 3 L. ed. 2d 421, 427, 79 S. Ct. 357 (1959). The ever-rising state tax rates and the increasing complexity and territorial expansion of business, all testify to the vital need today for a clearer definition of state powers in these critical areas.

The greatest opportunity ever offered to systemitize state taxation through Congressional legislation is today knocking at the door. Justices of this Court have on several occasions in recent decades urged Congress to make a survey of state taxation of multi-state businesses in the light of national needs and to prevent distortions in such taxation by establishing systematic integrated rules. See, e.g., *McCarroll* v. *Dixie Greyhound Lines, Inc.*, 309 U. S. 176, 189, 84 L. ed. 683, 60 S. Ct. 504 (1940, Black, Frankfurter and Douglas JJ.); *Northwest Airlines, Inc.* v. *Minnesota*, 322 U. S. 292, 88 L. ed. 1283, 64 S. Ct. 950 (1944, Black J., at 302; Jackson, J. at 306, 307); and *Northwestern States Portland Cement Co.* v. *Minnesota, supra*, (Frankfurter, J. at 476, 477). For such purposes, the due process clause seems peculiarly well fitted. Congress and the public have begun to move in this direction.

The enactment of Public Law 86-272 as amended (73 Stat. 555, 15 U. S. C. A. Section 381 et seq. (1959); 75 Stat. 41, 15 U. S. C. A. Section 381 n. (1961); and P. L. 87-435 (1962)) has, for the first time since the adoption of the Constitution, established certain rules for state imposition of taxes on, or measured by, net income derived from interstate commerce. This law also provides for a study by designated Congressional committees, which are to make their reports of such studies on or before July 1, 1963. A Special Subcommittee on State Taxation of Interstate Commerce has been organized within the House Committee on the Judiciary, has entered upon its studies, and has held hearings (hearings, 87th Cong., First Sess., ser. 14, held December, 1961); the most recent hearings in June, 1962, either have not yet been published or have not been made generally available in published form. The strong support for Congressional action is evidenced by the cited report of the

December, 1961, hearings and by numerous law review articles and other publications. Illustrative of this material, are the following, inspired by Public Law 86-272 and devoted entirely to state taxation problems: "Developments in the Law—Federal Limitations On State Taxation of Interstate Business," 75 Harvard Law Review 953 (1962); A Complete Issue of the Virginia Law Review, 46 Va. L. Rev. 1051 (1960); and the work prepared by the Committee on State and Local Taxes, Section of Taxation, American Bar Association, "A Compilation of Views Divergent and Otherwise on Current Important Problems in State and Local Taxation of Multi-State Businesses" (1962). This last named publication digests the diverse views held unofficially, by the Committee members (made up of men having a most diverse variety of experience) and others on the wisdom and nature of a federal statute to govern state taxation under the Federal Constitution. The present outlook for constructive legislation is most encouraging.

There are several unresolved constitutional problems in the state taxation of multi-state businesses which are currently important. Their authoritative resolution by this Court would give Congress guidance needed in the enactment of a comprehensive integrated statute to regulate state taxation. And, even if there is no further legislation by Congress, the clarification of these problems would be of substantial value to state legislative and judicial bodies, and to many taxpayers, including the appellant, which are faced with these problems under a variety of tax impositions.

The common thread running through the various facets of these and other questions is the problem of apportionment to avoid extraterritorial taxation.

Taxation without representation has been condemned since the time of our founding fathers. More recently in *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U. S. 33, 44; 84 L. Ed. 565, 570 (1940) this Court warned of:

> "* * * the recognized danger that, to the extent that the burden falls on the economic interest without the state, it is not likely to be alleviated by those political restraints which are normally exerted on legislation where it affects adversely interests within the state."

Conclusion.

Here the respondent seeks to impose an excise tax on extraterritorial values which it clearly could not have imposed if the tax were a property tax. There is a need to review this area of the law. It is respectfully submitted that the respondent's motion to dismiss should be denied and that this Court should note probable jurisdiction of this appeal.

Respectfully submitted,

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Appellant's Appendix F.

Excerpts from Transcript of Proceedings before Division of Tax Appeals, pp. 74-92 Seriatim.

[Appellant's Witness R. Bradner Mead is being examined by Appellant's attorney, Mr. Ward. Mr. Brochin is attorney for Respondent.]

Q. I refer you to Annex 12. There are five major columns on Annex 12, Mr. Mead, each broken down into two subcolumns. Will you explain in order the significance of each of those five columns? (75) A. Well, each of them takes the total net worth as determined by the Commissioner.

Q. What is that figure, for the record? A. For the first year, for tax year '54, it is $124,731,816.

Q. We will use that as an example. A. Then, in Column A, it distributes it amongst the various components of the corporation's business on the basis which the Commissioner used, which was the gross receipts of the taxpayer. Column 1 under A shows the percentage of gross receipts which were received from each component of the business and, multiplying each of those percentages by the 124,000,000, gives the portion of net worth that the Commissioner in effect allocated to each division of the business.

Then Column B shows the same kind of a distribution, using, instead of gross receipts, the assets of the taxpayer that were employed in each different component of the business.

. . . . . .

Q. Column C, what is that? A. Column C is following the same pattern, based on the consolidated assets of the corporation and its subsidiaries.

Q. Column D. A. Column D is based on the consolidated receipts of the taxpayer and its subsidiaries.

Q. What receipts are those, not in dollars, but describe (77) them; what are they? A. Going down the line, the receipts of subsidiaries are the total interest received from customers to whom they have lent money.

The receipts of the headquarters are miscellaneous receipts mentioned previously.

Appellant's Appendix F.

The receipts of HFC branches outside of New Jersey and in New Jersey are receipts of interest from customers to whom they have lent money.

Q. Column E? A. Column E takes the total net income of the consolidation and breaks it down again between the various components of the business, consolidated net operating income, again, which was defined to be the income before interest paid, Federal income taxes and non-operating items.

Q. Are you familiar with the summary figures pertaining to consolidated payroll of the taxpayer and its subs? A. Yes.

Q. Have you prepared a percentage relationship between the consolidated payroll of New Jersey branch office businesses and the total consolidated business of the taxpayer and subs? A. Yes.

(78) Q. What is that percentage?

. . . . . .

Q. Then there was an objection and a request to see the (79) document. For the year 1954, Mr. Mead, what is the percentage relationship between New Jersey branch payroll, Household, and consolidated payroll.

Mr. Brochin: Objection. Before you answer, please, I object to the question now on the ground that the answer which it calls for is not material or relevant to the issues here.

Mr. Ward: As to that, of course, your Honor, I am building up to a still further available allocation method, all directed to show how completely unreasonable and out of line with reality the Director's method is.

The Commissioner: Let me ask you this: as an ultimate conclusion in your case, do you propose to show the Division how the tax should have been computed?

Mr. Ward: Yes, sir, I will accept that.

The Commissioner: I am not suggesting anything. I am asking is that what you are going to do, is that your method, part of your method of showing the Division that this tax is wrong and what the tax should be?

(80) Mr. Ward: Let me elaborate, your Honor. We contend that the statute as literally written permits of enough discretion in the Director to achieve a constitutional, fair and just apportionment of this business. That is our statutory argument. We contend, of course, that his result was not either constitutional, fair, just or related to business realities.

If, however, it is ultimately determined that his method of apportionment was in literal compliance with the statute, then, as part of our constitutional argument, we are entitled to show that the method used was so far out of line with reality as compared to every other known and reasonable method of allocation, that it must be set aside as unconstitutional.

Consequently, any recognized and reasonable apportionment that we can adduce can be used either to show the Director how he should have interpreted the statute or, if the statute simply won't stretch that far, to show that the statute was unconstitutional.

The Commissioner: Well, let me suggest this to you——

Mr. Ward: And, of course, I mean with application to this particular case.

(81) The Commissioner: Let me suggest this to you: I am not certain at the moment, but it is my offhand understanding that the only judgment that the Division can make is a judgment which either sustains the Director or finds what the tax should have been. I don't think that the Division has the authority to say to the Director, "You did it wrong. Assuming that to be so, go back and do it over." In other words, I don't know that this Division has the

authority to remand, and therefore it would seem to me that, as a part of your case, you ought to be prepared to say what you think the tax should have been and how it should have been computed.

Mr. Ward: Actually, our petition prays that the tax as we reported it be reinstituted and accepted as the proper one.

The Commissioner: I thought that that might be the answer, that that may be what your contention is, and thus I can find some grounds on which to rule on the objections which are being made. In other words, it is very difficult at this point to see whether or not figures have any bearing, any figures have any bearing. Maybe the figures are not important (82) to me when I get done with the thing. Maybe it is just a matter of passing upon a formula. I don't know that, but if you tell me, I ask you and you say to me that what you are offering in evidence now forms part of your computation of the tax, or formed part of the computation of the tax that the Director levied, then I certainly find that whatever you are offering is admissible. If it doesn't, then I certainly need some explanation of why it is admissible.

Mr. Ward: Your Honor, we have set forth in Annex 12, four available methods of allocation. I am now developing a fifth, and I have a sixth up my sleeve. I don't say, your Honor, that an average of all six of them or any three or four of them should be taken. To that extent, they do not represent part of our tax computation. However, they do support the tax computation which we actually made in our return, which we are contending should be your judgment. They support it by the fashion of showing that it was a reasonable one, one with economic and business reality, which is ultimately what the statute requires. They are illustrative, if

you will; nevertheless, they are relevant for that purpose.

. . . . . .

Q. Did you, Mr. Mead, state what that relationship [of payroll] was for the year 1954, tax year? A. 3.27%.

Q. For the year 1955? A. 3.20%.

Q. '56? A. 2.96%.

Q. For 1957? A. 2.65%.

Q. Let me refer you back, please, to Annex No. 10, which is the so-called gross rates of return on loan account. Is it possible to relate the New Jersey Household Finance average loan account shown in Item No. 2 for each of the four years to the total consolidated average loan account shown in Item No. 3 for each of the four years? A. Yes.

Q. Have you done that computation? A. Yes.

(84) Q. What are your percentages? A. Tax year——

Mr. Brochin: Would you read back those questions?

(The last three questions and answers were read back by the Reporter.)

Q. For 1954 tax year, please. A. 4.03%.

Q. '55? A. 3.75%.

Q. '56? A. 3.31%.

Q. '57? A. 2.91%.

. . . . . .

Q. Mr. Mead, the four computations shown in columns B through E, and in the material you have just given us as (85) to consolidated payroll and loan account, what are those computations, speaking now as an accountant? A. Well, each is an attempt to take the total net worth of the corporation, which we have determined to be the same in each case, and spread it amongst the various components of the business on some equitable basis.

Q. As a Certified Public Accountant with long experience in financial business, do you have an opinion as to the

appropriateness and reasonable accurateness from an accountancy standpoint of the six apportionment methods you just described? A. Yes.

Mr. Brochin: Objection.

The Commissioner: Is this on Annex 12?

Mr. Ward: Referring to the four on Annex 12 plus the other two he stated being payroll and loan account percentages.

Mr. Brochin: If I may amplify my objection, your Honor, whether this witness thinks that the particular methods which he proposes would be fair and equitable means of apportionment, it seems to me, is completely irrelevant and immaterial.

(86) Mr. Ward: Of course, your Honor, I asked him to qualify his opinion as being from an accountancy standpoint. I am not eliciting a legal opinion from him now.

I think if Mr. Brochin questions his qualifications to hold such an opinion, he can find out about that on cross examination, but I am sure I have laid enough basis for this man, who is a highly-trained accountant, familiar with financial businesses, more than anybody else in the room, laid the basis for him to say whether or not any or all of those methods of apportionment are appropriate from an accountancy standpoint to the job that we have at hand.

The Commissioner: I think we will admit it. I think your objection goes to the weight rather than the admissibility, and we will admit it.

Q. What, then, is your opinion as to the appropriateness and reasonable accuracy from an accountancy standpoint of the six apportionment methods? A. Well, I think each method would produce reasonably accurate results. None of them are perfect. Each has some defects, but they all bear some relationship to the contribution to net worth of each individual segment of (87) the business of the corporation. Take, as an example, consolidated assets. Assets.

Q. Let me interrupt. Are you referring to column C of Annex 12? A. Yes, column C. Certainly assets contribute to net worth, one of the basic contributions to net worth, and spreading the net worth amongst the various components of the business on the basis of the assets would be a valid spread. The assets of each portion of the business are quite comparable in type to the assets of other portions of the business. Similarly with salaries, the other thing that contributes to the value of a business besides the assets of the business is the work done by the people who are working for the business, and the salaries of the people working for the business to some extent are certainly a measure of the contribution to the net worth of that segment of the business, and again the people employed in the different segments of the business, the salaries of them is a comparable item, comparing one segment of the business to another segment.

Q. I notice that in column D the consolidated receipts technique, and in column E the consolidated net operating technique, produces a zero value for headquarters' (88) property. Do you have an opinion as to the appropriateness of those two methods of apportionment in the light of that fact? A. Yes. As I said, each method has some defect. The defect of those two methods is, and also the sixth method, the consolidated loans outstanding method, is that they do not give any effect to the contribution by the headquarters, located wherever it may be located.

Q. Do you have an opinion, on the same basis as my original question about opinion, as to the appropriateness and reasonable accuracy of the method of apportionment which you have told us is reflected in column A of Annex 12? A. Yes.

Q. What is that opinion? A. My opinion is that it is not a valid method of apportionment. It creates a great distortion because, while it is based on gross receipts, the gross receipts of the different components of the business are not the same types of gross receipts, plus the added factor that, the same as in the three methods we just dis-

cussed, it gives no effect or practically no effect to the contribution of headquarters. And, to elaborate on those gross receipts, the gross receipts of the component of (89) the business, that is branches outside of New Jersey and also that of the branches in New Jersey, is the money that the branches have taken in from customers to whom they have lent money.

The gross receipts of Household Finance Corporation, the taxpayer, from the component of its business, that is investment in subsidiaries, is simply whatever dividends they may happen to pay to the parent company and whatever interest they pay on money borrowed from the parent company.

Looking beyond the parent company to the gross receipts of the subsidiaries' portion of the business that would be comparable to the gross receipts of the branch business in New Jersey and outside of New Jersey it would be the actual gross receipts that those subsidiaries received from their customers, rather than simply the interest and dividends from the subs.

There are two defects in interest and dividends, one being they are in effect something less than the net profit of the subs, the other being that they can vary from year to year, according to how the subs happen to pay them to the parent, without regard to the actual net worth in that investment in subs during that year.

(90) Q. In your opinion, as I have previously stated on the same basis——

Mr. Brochin: And with the same objection.

Q. And with the same objection, is the spread variously between your six figures of 3.68% assets of the taxpayer, 3.59% consolidated assets, 4.05% consolidated receipts, 4.11% consolidated net operating income, 3.27 payroll and 4.03 loan account percentage an acceptable spread from an accountancy standpoint for the purpose of reflecting true division of adjusted net income? A. I

would say so. They are all fairly close together, and we have already mentioned the reasons why some of them differ from others.

* * * * * *

Q. Mr. Mead, you described this morning six alternate methods of apportionment. Were any of the methods you described this morning the ones which petitioner actually used on its returns? A. No.

Q. Will you describe for us, please, the methods which petitioner actually did use on its returns? A. We used two different methods amongst the six. First of all, we took the total net worth, and we excluded from that a portion attributable to the investment in subsidiaries. We did that on an asset basis. We took a fraction, of which the numerator was the asset investment in stock of and advances to subsidiaries. The denominator was total assets. Then that fraction was applied to the total net worth, to determine the portion of net worth attributable to investment and subsidiaries.

The remainder of net worth was allocated to New (92) Jersey and conversely to outside New Jersey on gross receipts fraction, excluding from gross receipts any gross receipts from the subsidiaries, since they had already been pulled out of the net worth.

Q. In your opinion, on the same basis as your opinion evidence of this morning, is that method of allocation an appropriate and reasonably accurate method of apportioning the net worth of a financial business? A. Yes.

Mr. Brochin: Would you read the question?

(The question was read by the Reporter.)

Mr. Brochin: Objection, your Honor.

The Commissioner: Overruled.

Q. Is it consistent from an accountancy standpoint with the other methods you described to us this morning? A. Yes.

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